

Fixing or Killing Off Broken Trusts

(Including 2017 Statutory Changes)

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“The New Guardianship Rules Regarding Inventories, Monthly Allowances and Investments,” State Bar of Texas Guardianship Law Course (2004).

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1. Introduction

One of the ironies of the enactment of the generation-skipping transfer tax (“GST”) in 1986 is that a statute designed to curb using trusts for multigenerational planning actually encouraged multigenerational planning. By taxing generation-skipping transfers to the extent they exceeded the lifetime GST exemption amount, estate planners found a new basis for trust planning: if the government is going to allow generation-skipping planning up to the exemption amount, then families ought to take advantage of it.

For this and other reasons, the use of trusts having long terms has increased dramatically. As these trusts mature, families and estate planners are discovering that the trust terms used at the time the trust was created often fail to address the family’s needs and fail to meet the industry standard of trusts today. This paper calls these “broken trusts.”²

Not coincidentally, as the practice of using long-term trusts has grown, there has been a movement toward finding ways to change or terminate broken trusts. This movement is happening on four fronts:

1. Drafters are including provisions in new trust documents which permit adjustment of trust terms in the future.
2. Statutes are being amended to liberalize modification or termination of trusts.

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² These trusts may have been expertly and correctly drafted. They may have accurately represented the settlors’ intentions at the time they were signed. They are called “broken” in this paper because they have that attribute to the persons desiring to change or terminate them.

3. The legal academic community and the courts have moved the needle in the direction of deviating from the settlor's literal terms in appropriate cases.
4. Attorneys working on broken trusts are becoming craftier at using the available tools to fix or terminate them.

This paper mentions strategies which drafters may use to build flexibility into new trust documents. It then takes a close look at the evolving law of judicially modifying and terminating irrevocable trusts. Finally, it discusses the tools – some old, some new – in the attorney's toolbox to fix or terminate broken trusts without going to court, including decanting and combining trusts.

2. Drafting with the Future in Mind

This paper mostly focuses on fixing or terminating existing broken trusts. Still, it is worth noting some of the things drafters of trusts can do to make it easier to adjust to future events. While these strategies build in flexibility, some of them are inappropriate in specific cases. Still, it is the author's opinion that the default approach of the drafter should be to provide flexibility.

Appendix A contains some sample trust provisions to consider using when maximum flexibility is desired.

2.1. *Provide Broad Trustee Discretion and Powers*

By far, the best way to provide flexibility in the future is to grant the trustee broad discretion – or, at least, broad discretion to the extent permitted by tax law – and to give the trustee broad powers. A settlor creating a trust which may last 10+ years (especially a multigenerational trust) cannot anticipate all of the circumstances which may arise. If the settlor restricts the trustee as to investments or distributions, modification is much more likely to be necessary. Of course, this approach makes selection of the trustee critical and it will not work in all situations. There may be factors which make wide discretion inappropriate.

Consider the following approaches:

- Use a broad discretionary distribution standard if an ascertainable standard is not required for tax purposes.
 - Precatory advice about details of distribution decisions is preferable to mandatory instructions and helps overcome a corporate trustee's reluctance to be left with broad discretion.
 - A savings provision may be used to convert the trust to an ascertainable standard trust if a beneficiary becomes trustee. Also, Section 113.029(b) of the Texas Trust Code may convert the trust to an ascertainable standard trust if a beneficiary becomes a trustee.

- Use a simple “health, education, maintenance and support” standard if an ascertainable standard is required.
 - Precatory advice about details of distribution decisions is preferable to mandatory instructions or modifications to the standard.
 - *Permit* the trustee to consider factors such as other resources or standard of living; do not *require* them to be considered.
 - Do not require exhaustion of the marital trust before making principal distributions from the bypass trust, especially now that basis adjustment may be more important than estate tax savings.
- Expand default trust code powers rather than contracting them, and make sure boilerplate trustee powers do not limit default powers.

2.2. *Include Robust Successor Trustee Provisions*

Using long-term trusts makes it more likely that the original trustee will be unable to serve until trust termination. Even if a corporate trustee is used, it often is necessary or appropriate to change corporate trustees or change from a corporate trustee to an individual trustee.

Section 113.083(a) of the Texas Trust Code provides that, on the death, resignation, incapacity, or removal of a sole or surviving trustee, a successor trustee shall be selected according to the method, if any, prescribed in the trust instrument. If a successor cannot be selected under the method prescribed in the trust instrument, a court appoints a successor trustee. Unless the family situation is extremely dysfunctional or a trust is a court-created trust, the drafter should take steps to make it unnecessary to go to court to appoint a successor trustee.

Consider using one or more of the following methods to select new trustees:

- Include a lengthy list of successor trustees.
- Give individual trustees the power to appoint their successors and to designate who should succeed them in the event of their death, resignation or incapacity, and consider giving the trustee’s designation precedence over the list of successors named in the trust instrument.
- Give a third party such as a trust protector or trustee appointer the power to appoint successor trustees and to designate who should succeed as trustee in the event of the death, resignation or incapacity of the then-serving trustee, and consider giving the third party’s designation precedence over the list of successors named in the trust instrument.

- Allow an individual beneficiary with capacity to remove and replace a corporate trustee with another corporate trustee, and consider allowing the parent or guardian of a minor or incapacitated beneficiary to hold this power on the beneficiary's behalf.
- Define a mechanism for determining when the requirement of a corporate trustee ends and an individual trustee is permitted.

2.3. Permit Change of Situs

Often problems may be solved if the trust can be made subject to another state's laws. This increases flexibility, but it could frustrate the settlor's intent if the trust is made subject to a state's laws which permit actions beyond the scope of what the settlor intended.

2.4. Include a Decanting Provision

Rather than relying on the Texas decanting statute, include an express provision allowing the trustee to transfer part or all of the trust property to another trust. An express provision is not subject to the strict Texas rules.³ Care must be taken to avoid tax problems, however. This may be addressed by using an independent trustee, a special trustee with limited powers, an independent trust protector with the power to direct the trustee to decant, and by including a savings provision.

2.5. Creative Use of Trust Protectors

The growing use of trust protectors provides significant flexibility to address future problems. Care must be taken to avoid tax problems, however. The trust either needs to have an independent trust protector or it needs to have a mechanism for appointing an independent or special trust protector.

In appropriate cases, a trust protector may be given the power to:

- Change trustees.
- Change the distribution standard within parameters set by the settlor in the trust instrument.
- Change or redefine beneficiaries.
- Direct the trustee to change the situs of the trust.
- Direct the trustee to decant.

³ See "Decanting" below.

- Amend the trust to achieve the settlor's tax objectives.
- Make substantive amendments to the trust.
- Terminate a trust early.
- Grant a general or special power of appointment.

2.6. Use Liberal Trust Division and Combination Provisions

The Texas division and combination of trusts statute⁴ is an extremely useful and often overlooked way to fix administrative provisions in a broken trust. However, statutory division or combination cannot “impair the rights of any beneficiary or adversely affect achievement of the purposes of” the original trust or trusts. This makes it unusable, for example, to divide a pot trust for three children into separate trusts for each child or to merge a trust without a power of appointment into one with a power of appointment.

The terms of the trust instrument may be drafted to expand the default rule about division and combination of trusts. Consider permitting divisions and combinations one or more of these situations:

- Dividing a pot trust into separate trusts.
- Dividing a trust to prevent a GST inclusion ratio of between zero and one.
- Merging a trust subject only to Texas law into a trust which permits a change of situs.

2.7. Use Care About Including Remote Charitable Beneficiaries

Despite the drafter's best efforts, if a trust lasts long enough, it is likely to end up involved in a judicial proceeding. Estate planning clients should be warned about possible charity and attorney general involvement in will construction and trust modification proceedings.⁵ If the decision to include the charity as a last resort beneficiary is just an afterthought, clients may wish to consider another way to handle the issue.

If a client has strong philanthropic feelings, by all means charitable gifts should be included in the estate planning documents. In that case, consider making the gifts to the charities separate from the family gifts. In other words, do not make the charity a beneficiary of the general family

⁴ Tex. Trust Code §112.057.

⁵ See “Charity/Attorney General Involvement” below.

trust — make an outright bequest to the charity or make the gift to the charity in a separate trust.⁶ By using this approach, the charity and the attorney general may not be a necessary party to suits involving the family trust.

Trust instruments making charitable gifts should be drafted to avoid the need for attorney general involvement if the named charity ceases to exist. This provision should permit the trustee to select a substitute charity nonjudicially and without notice to or approval of the attorney general.

3. Judically Modifying and Terminating Irrevocable Trusts

Trusts, being creatures of equity, are subject to the equitable powers of the courts even when they are irrevocable and unamendable by their own terms. This section of the paper discusses the law regarding modifying and terminating trusts and the methods available for such action. It then examines some of the practical problems attorneys face when seeking to modify or terminate a trust, including the problems typically faced by the trustee, the income beneficiary and the remainder beneficiary.

3.1. Common Law

Prior to the enactment of the Texas Trust Code in 1983, there was no specific statutory authorization for modifying or terminating trusts outside of the trusts' terms. The only statutory authority in the Texas Trust Act (predecessor to the Code) was Section 46(c):⁷

Nothing contained in this Section of this Act shall be construed as restricting the power of a court of competent jurisdiction to permit and authorize the trustee to deviate and vary from the terms of any will, agreement, or other trust instrument relating to the acquisition, investment, reinvestment, exchange, retention, sale, supervision or management of trust property.

That oblique reference is consistent with the common law doctrine of deviation. It was this doctrine which gave courts the authority to modify or terminate trusts other than in accordance with their terms prior to the adoption of the Texas Trust Code. This doctrine was expressed by the Dallas Court of Civil Appeals in *Amalgamated Transit Union, Local Division 1338 v. Dallas Public Transit Board* as follows:

A court of equity is possessed of authority to apply the rule or doctrine of deviation implicit in the law of trusts. Thus a court of equity will order a deviation from the terms

⁶ Obviously, split interest gifts such as charitable remainder unitrusts have to have both charitable and noncharitable beneficiaries.

⁷ V. A. T. S. art. 7425b-46 C, repealed effective January 1, 1984.

of the trust if it appears to the court *that compliance with the terms of the trust is impossible, illegal, impractical or inexpedient, or that owing to circumstances not known to the settlor and not anticipated by him, compliance would defeat or substantially impair the accomplishment of the purpose of the trust.* [citation omitted] In ordering a deviation a court of equity is merely exercising its general power over the administration of trust; it is an essential element of equity jurisdiction.⁸

If this part of the *Amalgamated Transit Union* opinion has a certain ring to it, it is because the same language was codified into Section 112.054 of the Texas Trust Code in 1984, discussed below.

Are there limits on the court's equitable powers to deviate from the trust instrument? Bogert and Bogert, in their treatise on trusts and trustees, draw a distinction between the dispositive provisions and the administrative provisions of a trust. While the court clearly has the power to deviate from the administrative provisions of the trust instrument in order to give full effect to the dispositive or beneficial provisions, it must proceed more carefully when deviating from the dispositive or beneficial scheme.⁹ This does not mean that a court has no power to alter the settlor's dispositive scheme, rather it means the court must exercise more care. Examples in Bogert where the dispositive scheme may be altered are cases where a statute (such as Tex. Trust Code §112.054, discussed below) supports the court action or cases where the parties to litigation enter into a compromise agreement altering trust terms which the court finds to be fair and reasonable.¹⁰

Some Texas courts were reluctant to apply these equitable principles (or at least to extend them to their possible ends) prior to the adoption of the Texas Trust Code. For example, in *Frost National Bank of San Antonio v. Newton*,¹¹ the Texas Supreme Court held that a trust could not be terminated on the basis that its principal purposes had been satisfied because the court could not substitute its judgment for the settlor in determining which purposes she considered "principal" and which were merely "incidental."¹²

Because of this inconsistency and because of the uncertainty surrounding application of these equitable principles, Section 112.054 was a welcome addition to Texas's statutes in 1984.

⁸ *Amalgamated Transit Union, Local Division 1338 v. Dallas Public Transit Board*, 430 S. W. 2d 107, 117 (Tex. Civ. App. — Dallas 1968, writ ref'd), cert. denied, 396 U. S. 838 (1969) [emphasis added]. See also Restatement (Second) of Law of Trusts, 2nd Edition, §167, and Restatement (Third) of Law of Trusts §66.

⁹ See Bogert, *Trusts and Trustees* (2nd Ed. Rev.), §561.

¹⁰ See Bogert, *Trusts and Trustees* (2nd Ed. Rev.), §994.

¹¹ 554 S. W. 2d 149 (Tex. 1977).

¹² 554 S. W. 2d at 154.

The principles permitting modification or termination of trusts were significantly broadened by the 2005 amendments to Section 112.054, discussed below. The author sees this as part of a general trend toward greater and greater power of courts to tinker with irrevocable trusts. The increased flexibility of trust administration (of which the Uniform Prudent Investor Act and the Uniform Principal and Income Act, enacted in Texas in 2003, are examples) increases the need for (and, in more and more cases, the willingness of) courts to place themselves in the settlor's shoes in dealing with changing circumstances.

Because of this trend, the common law rules regarding trust modification and termination remain important. Section 111.005 of the Texas Trust Code provides that common law rules will prevail except as the Trust Code changes such rules. Thus, even after the enactment of the Trust Code, Section 112.054 may not be the exclusive basis for modifying or terminating a trust. In an appropriate case, a court of competent jurisdiction could modify or terminate a trust for other reasons or on another basis using its general equity powers. The 2017 changes to Section 112.054 make it clear that enactment of that statute does not replace other bases for reformation in equity or common law.¹³

3.2. *Tex. Trust Code §112.054*

The enactment of Section 112.054 of the Texas Trust Code in 1984 not only solidified the power of courts to modify or terminate trusts, it also provided a framework for such proceedings. It was based on the doctrine of deviation as stated in Section 167 of the Restatement of the Law of Trusts, Second Edition, and in the *Amalgamated Transit Union* opinion.¹⁴

3.2.1. *The 2005 Changes*

In 2005, legislation sponsored by the Real Estate, Probate and Trust Law Section of the State Bar of Texas (REPTL) sought to pick out the best parts of the Uniform Trust Code (which was not adopted as a whole in Texas) for addition to the Texas Trust Code. Most of the trust modification and termination provisions of the Uniform Trust Code were imported into Section 112.054.

Here is what the author said about the 2005 changes in that session's legislative update:¹⁵

¹³ Tex. Trust Code §112.054(f).

¹⁴ 430 S. W. 2d 107, 117 (Tex. Civ. App. — Dallas 1968, writ ref'd), cert. denied, 396 U. S. 838 (1969). See also Guide to the Texas Trust Code, 3rd Edition (1996), p.10.

¹⁵ O'Connor's Probate Code *plus* (2005-2006), p. xviii and <http://texasprobate.net/05leg/2005legupdate.pdf>.

The changes to Section 112.054 are based on Sections 410, 411, 412 and 416 of the Uniform Trust Code. They represent a significant modernization of the statute regarding judicial modification or termination of irrevocable trusts.

Under prior law, it was necessary to prove either (1) that the purposes of the trust had been fulfilled or become impossible or illegal to fulfill or (2) that, because of circumstances not known to or anticipated by the settlor, compliance with the terms of the trust would defeat or substantially impair the purposes of the trust. This standard was a codification of the pre-Trust Code common law modification standard expressed in *Amalgamated Transit Union, Local Division 1338 v. Dallas Public Transit Board*, 430 S.W. 2d 107, 117 (Tex. Civ. App. — Dallas 1968, writ ref'd), cert. denied, 396 U.S. 838 (1969).

The 2005 changes preserve the first of the two bases for modifying or terminating a trust – that the purposes have been fulfilled or become impossible or illegal to fulfill – but it liberalizes the second basis and adds three new bases for modifying or terminating a trust:

In cases of circumstances not anticipated by the settlor, rather than having to prove that compliance with the terms would defeat or substantially impair the accomplishment of the purposes of the trust, Subsection (a)(2) now provides that one must prove merely that the modification or termination “will further the purposes of the trust.” This is a much easier standard to meet and is much more logical.

Subsection (a)(3) permits “administrative, nondispositive” provisions of the trust to be modified if “necessary or appropriate to prevent waste or avoid impairment of the trust's administration.” No inquiry into the settlor's knowledge or intent is required.

Subsection (a)(4) permits modifications or terminations if necessary to achieve the settlor's tax objectives, so long as the action is “not contrary to” the settlor's intentions. These changes may be given retroactive effect. Whether or not these modifications – especially retroactive modifications – will be successful for tax purposes is uncertain. According to the official comments of the National Conference of Commissioners on Uniform State Laws to Section 416 of the Uniform Trust Code:

Whether a modification made by the court under this section will be recognized under federal tax law is a matter of federal law. Absent specific statutory or regulatory authority, binding recognition is normally given only to modifications made prior to the taxing event, for example, the death of the testator or settlor in the case of the federal estate tax. See Rev. Rul. 73-142, 1973-1 C.B. 405. Among the specific modifications authorized by the

Internal Revenue Code or Service include the revision of split-interest trusts to qualify for the charitable deduction, modification of a trust for a noncitizen spouse to become eligible as a qualified domestic trust, and the splitting of a trust to utilize better the exemption from generation-skipping tax.

Subsection (a)(5) permits the trust to be terminated if its continued existence is not necessary to achieve any material purpose of the trust or for the trust to be modified in any manner which is “not inconsistent with a material purpose of the trust.” However, Subsection (a)(5) changes are permitted only if all beneficiaries agree. Virtual representation concepts may be used in obtaining beneficiary consent pursuant to Subsection (d).

The 2005 changes are a clear expansion of the bases for judicial modification or termination of irrevocable trusts and make it easier to meet the statutory standard. Texas courts have stated that the 2005 changes “liberalized the rules governing modification and termination of trusts.”¹⁶ The 2005 changes permit modifications “that enhance the attainment of the settlor's trust purposes.”¹⁷

The 2005 changes to Section 112.054 apply to trusts existing on January 1, 2006, as well as to trusts created on or after January 1, 2006. With respect to trusts already in existence on that date, the 2005 changes “apply only to an act or omission relating to the trust that occurs on or after January 1, 2006.”¹⁸

Since this statute forms the basis for virtually all suits to modify or terminate a trust in Texas, this paper will examine each of its elements in detail.

3.2.2. *The 2017 Changes*

In 2017, the Texas Legislature enacted SB 617¹⁹. This bill made key changes to Section 112.054 and related statutes.

¹⁶ *In re Willa Peters Hubberd Testamentary Trust*, 432 S. W. 3d 358, 365 (Tex. App. – San Antonio 2014).

¹⁷ *In re White Intervivos Trusts*, 248 S. W. 3d 340, 342 (Tex. App. – San Antonio 2007 no pet.), quoting Stanley M. Johanson, Johanson's Texas Probate Code Ann., Texas Property Code § 112.054, commentary (2007 ed.).

¹⁸ HB 1190, Section 31, 79th Texas Legislature (2005).

¹⁹ SB 617, Sections 4 and 5, 85th Texas Legislature (2017).

A. *Trust Reforms are Permitted*

When the 2005 changes were made to Section 112.054, Uniform Trust Code Section 415²⁰ – “Reformation to Correct Mistakes” – was not picked up. REPTL’s rationale in 2005 was that Texas’s common law regarding reformation of trust was adequate.

In 2015, Section 255.451 was added to the Estates Code to permit modifications and reformations of wills.²¹ Among other grounds, Section 255.451 permits modification or reformation of a will “to correct a scrivener’s error in the terms of the will, even if unambiguous, to conform to the testator’s intent,” so long as the scrivener’s error is established by clear and convincing evidence. REPTL had intended to make a similar change to Trust Code Section 112.054 in 2015, but its Trust Code bill did not pass. The enactment of SB 617 in 2017 makes that change to the Trust Code.

SB 617 adds new Subsection (b-1) to Section 112.054, which permits a court to order that the terms of a trust be reformed if:

- (1) reformation of administrative, nondispositive terms of the trust is necessary or appropriate to prevent waste or impairment of the trust's administration;
- (2) reformation is necessary or appropriate to achieve the settlor's tax objectives or to qualify a distributee for governmental benefits and is not contrary to the settlor's intentions; or
- (3) reformation is necessary to correct a scrivener's error in the governing document, even if unambiguous, to conform the terms to the settlor's intent.

Subsection (e) requires reformation due to scrivener’s error to be established by clear and convincing evidence.

Subsection (f) was added to make clear that Subsection (b-1) is not intended to state the exclusive basis for reformation of trusts, and the bases for reformation of trust in equity or common law are not affected by Section 112.054.

A related change was made to Trust Code Section 111.0035(b)(5)(A) to provide that the terms of a trust may not limit the power of a court to modify, *reform*, or terminate a trust or take other action under Section 112.054.

²⁰ Section 415 of the Uniform Trust Code permits a court to reform the terms of a trust to conform with the settlor’s intention if both the settlor’s intent and the terms of the trust were affected by a mistake of fact or law, whether in expression or inducement.

²¹ For a full discussion of the will reformation statute, see Glenn Karisch’s 2015 Legislative Update, pp. XXIV – XXV, O’Connor’s Texas Estates Code *plus* (2015-16) or <http://texasprobate.com/download-cle-articles/2015%20Legislative%20Update.pdf>.

B. *Modifications to Qualify a Distributee for Governmental Benefits.*

SB 617 amended Section 112.054(a)(4) to permit modifications and other actions that are necessary or appropriate to qualify a distributee for governmental benefits, so long as the modification is not contrary to the settlor's intention. Thus, a trust may be modified under Section 112.054(a)(4) or reformed under Section 112.054(b-1)(2) to qualify a distributee for government benefits.

C. *2017 Changes Apply to New and Existing Trusts*

The changes made by SB 617 are effective September 1, 2017, and apply to trusts existing on September 1, 2017, as well as to trusts created on or after September 1, 2017. With respect to trusts already in existence on that date, the 2017 changes "apply only to an act or omission relating to the trust that occurs on or after September 1, 2017."²²

3.2.3. *Trustee or Beneficiary May Bring Suit*

Section 112.054(a) and (b-1) provide that a trustee or a beneficiary may petition the court. A "beneficiary" is a person "for whose benefit property is held in trust, regardless of the nature of the interest."²³ Thus, any beneficiary — income, remainder, contingent remainder — has standing to bring a modification, termination or reformation suit under Section 112.054.

Section 112.054 does not authorize a *settlor* to bring a suit. A settlor may be an "interested person" for purposes of Section 115.011 ("Parties") and by such section be authorized to initiate a proceeding under Section 115.001 ("Jurisdiction"). *See Tex. Trust Code §§ 111.004(7), 115.001 and 115.011(a).*²⁴ It is unclear, however, if this general authority to commence an action regarding a trust would be sufficient for a settlor to survive a standing challenge if the settlor sought to initiate a Section 112.054 action.

In *In re Willa Peters Hubberd Testamentary Trust*,²⁵ pursuant to a mediated settlement agreement, a court-appointed mediator filed a petition to modify a trust under Section 112.054. A party objected, since the mediator was neither a trustee nor a beneficiary. The appellate court found that the mediator had standing to bring the action because the mediator was "an attorney

²² SB 617, Sections 17 and 18, 85th Texas Legislature (2017).

²³ Tex. Trust Code §111.004(2).

²⁴ Section 115.001 of the Texas Trust Code does not contain the "trustee or beneficiary" limitation. It may be possible for an interested person who is not a trustee or beneficiary to bring what amounts to a modification or termination action under the broad provisions of Section 115.001 without relying on Section 112.054. *See "Who May Initiate Suit"* below.

²⁵ 432 S. W. 3d 358 (Tex. App. – San Antonio 2014).

who was authorized to represent the beneficiaries and the trustee in filing the petition.”²⁶ Therefore, while it is preferable to have the trustee or a beneficiary directly bring the action, the door is open for someone “representing” the trustee or the beneficiary to bring the action.

3.2.4. *Actions the Court is Authorized to Take*

Section 112.054 is entitled “Judicial Modification, Reformation or Termination of Trusts.” Nonetheless, it authorizes the court to do more than modify, reform or terminate a trust. Under Section 112.054(a), the court is authorized to:

- Change the trustee;
- Modify the terms of the trust;²⁷
- Direct or permit the trustee to do acts that are not authorized or that are forbidden by the terms of the trust;
- Prohibit the trustee from performing acts required by the terms of the trust; or
- Terminate the trust in whole or in part.

Under Section 112.054(b-1), a Court may order that the terms of a trust be reformed.

One can imagine the meeting of the committee which drafted the Trust Code when the list in Section 112.054(a) was developed — a bunch of trust lawyers thinking of all of the things they had ever tried to do and been frustrated in doing. The list is fairly all-encompassing, but it is interesting to compare it with the list of things a court is authorized to do under the “jurisdiction” section of the code (Section 115.001). The following chart compares the two lists:

²⁶ 432 S. W. 3d at 363.

²⁷ A possible legislative change in 2017 is to permit the court to “modify or reform” the trust terms. See “Possible 2017 Legislation” below.

<i>Section 112.054(a) and (b-1)</i>	<i>Section 115.001(a)</i>
Change the trustee	(3) Appoint or remove a trustee
Modify or reform the terms of the trust	(4) Determine the powers, responsibilities, duties, and liability of a trustee (6) Make determinations of fact affecting the administration, distribution, or duration of a trust (7) determine a question arising in the administration or distribution of a trust (8) relieve a trustee from any or all of the duties, limitations, and restrictions otherwise existing under the terms of the trust instrument or the Trust Code
Direct or permit the trustee to do acts that are not authorized or that are forbidden by the terms of the trust	(4) Determine the powers, responsibilities, duties, and liability of a trustee (6) Make determinations of fact affecting the administration, distribution, or duration of a trust (7) determine a question arising in the administration or distribution of a trust
Prohibit the trustee from performing acts required by the terms of the trust	(4) Determine the powers, responsibilities, duties, and liability of a trustee (6) Make determinations of fact affecting the administration, distribution, or duration of a trust (7) determine a question arising in the administration or distribution of a trust (8) relieve a trustee from any or all of the duties, limitations, and restrictions otherwise existing under the terms of the trust instrument or the Trust Code

Section 112.054(a) and (b-1)	Section 115.001(a)
Terminate the trust in whole or in part	<p>4) Determine the powers, responsibilities, duties, and liability of a trustee</p> <p>(6) Make determinations of fact affecting the administration, distribution, or duration of a trust</p> <p>(7) determine a question arising in the administration or distribution of a trust</p> <p>(8) relieve a trustee from any or all of the duties, limitations, and restrictions otherwise existing under the terms of the trust instrument or the Trust Code</p>
[No corresponding action]	<p>(1) Construe a trust instrument</p> <p>(2) Determine the law applicable to a trust instrument</p> <p>(5) Ascertain beneficiaries</p> <p>(9) Require an accounting by a trustee, review trustee fees, and settle interim or final accounts</p> <p>(10) Surcharge a trustee</p>

Section 115.001 was amended in 2007: (1) to give district courts (and statutory probate courts) jurisdiction “over all proceedings by or against a trustee” as well as over all proceedings on the laundry list. (Subsection (a)); and (2) to provide that the laundry list in Subsection (a) is not exhaustive. (Subsection (a-1)).

Though entitled “Jurisdiction,” Section 115.001 is more than a jurisdiction section — it is the substantive basis for causes of action. For example, Section 115.001(a) is the only authority in the Trust Code for a judicial settlement of interim or final accounts. Because of this, and because of the general equitable powers of the courts with respect to trusts, it is a good idea to plead both Section 112.054 and Section 115.001 as bases for modifying, reforming or terminating a trust. Then, if the proof does not exactly match the specific categories expressed in Section 112.054, general equitable principles and Section 115.001 can be relied upon.

3.2.5. *Findings Required*

A. *Prior to 2005 Changes*

Prior to the 2005 changes, the court act under Section 112.054 if it found that one of the two following conditions had occurred: (1) the purposes of the trust have been fulfilled or have

become illegal or impossible to fulfill; or (2) because of circumstances not known to or anticipated by the settlor, compliance with the terms of the trust would defeat or substantially impair the accomplishment of the purposes of the trust.

These findings were virtually identical to those applicable under the common law doctrine of deviation.²⁸

Of these two grounds for action, unknown or changed circumstances was by far the most common basis under the prior law. It provided more flexibility. Nonetheless, it set a high standard – no change was possible absent a showing that following the trust instrument as written would “defeat or substantially impair” accomplishment of the “purposes” of the trust.

B. *Findings Required Under Current Statute – Subsection (a)*

The 2005 change kept the first ground, reduced the level of proof required for the second ground and added three new grounds for modifying or terminating a trust. A trust may be modified or terminated, etc., if: (2005 and 2017 changes shown)

(1) the purposes of the trust have been fulfilled or have become illegal or impossible to fulfill; [or]

(2) because of circumstances not known to or anticipated by the settlor, the order will further the purposes of the trust;

(3) modification of administrative, nondispositive terms of the trust is necessary or appropriate to prevent waste or avoid impairment of the trust's administration;

(4) the order is necessary or appropriate to achieve the settlor's tax objectives or to qualify a distributee for governmental benefits and is not contrary to the settlor's intentions; or

(5) subject to Subsection (d):

(A) continuance of the trust is not necessary to achieve any material purpose of the trust; or

(B) the order is not inconsistent with a material purpose of the trust [compliance with the terms of the trust would defeat or substantially impair the accomplishment of the purposes of the trust].

²⁸ See *Amalgamated Transit Union, Local Division 1338 v. Dallas Public Transit Board*, 430 S. W. 2d 107, 117 (Tex. Civ. App. — Dallas 1968, writ ref'd), cert. denied, 396 U. S. 838 (1969) (quoted above).

Following is a discussion of each of these bases for modifying or terminating a trust:

1. *Impossible to Fulfill Purposes*

The first possible finding probably is the least common. One may take the position that the purposes of a trust for a minor have been fulfilled if the beneficiary has attained a level of age and maturity where the trust is no longer necessary. Also, one can imagine certain fact patterns where the trust, when drafted, called for the trustee to take certain legal actions (for example, actions based on race or ethnicity) which, through the passage of time and changes in the law, now are illegal. For the most part, however, this will not be the basis for modifying or terminating most trusts.

2. *Unknown or Unanticipated Circumstances*

The 2005 changes to this standard make it much easier to meet. Instead of having to show that the unknown or unanticipated circumstances would mean that complying with the unmodified trust would “*defeat or substantially impair* the accomplishment of the purposes of the trust,” the applicant need only show that, because of the changed circumstances, modifying or terminating the trust “*will further the purposes of the trust.*”

However, despite the fact that courts have recognized the 2005 changes as liberalizing the trust modification and termination rules, one Texas court has narrowly read Section 112.054(a)(2), making it more difficult than it should be to modify or terminate a trust under this provision. In *In re Willa Peters Hubberd Testamentary Trust*,²⁹ the Court focused its attention on the “purposes of the trust.” It cited *Frost National Bank of San Antonio v. Newton*³⁰ – a case decided under the prior, stricter statute – in concluding that the trust had two purposes – to distribute all of the income to two beneficiaries and to provide for the health, support, education and maintenance of those beneficiaries and more remote beneficiaries.³¹ The *Hubberd* court could have taken a much broader view of the purposes of the trust – to support and benefit the beneficiaries – but it took this narrower view. It found that the court could modify the trust to require a beneficiary to maintain insurance as a condition to receiving distributions because maintaining insurance would further the trust purpose of to provide for the health and support of the beneficiaries, but it found that requiring insurance premiums to be paid from trust income would not further the purpose of distributing the “entire net income” of the trust to certain beneficiaries.³² Since the court found two purposes of the trust, it followed the 1977 *Newton*

²⁹ 432 S. W. 3d 358 (Tex. App. – San Antonio 2014).

³⁰ 554 S. W. 2d 149 (Tex. 1977).

³¹ 432 S. W. 3d at 367.

³² 432 S. W. 3d at 367.

decision in determining that it could not elevate one purpose (providing for health and support) over the other (paying all income), and prohibited the modification.³³

In the author's opinion, the *Hubberd* court's view is much too narrow. By providing for distribution of all income and for distributions for health, education, maintenance and support, the settlor's primary purpose clearly is supporting and caring for those beneficiaries, so if the court finds a better way to do it that the settlor could not have anticipated, the court should have the authority to do so under Section 112.054(a)(2) – to further the purposes of the trust.

3. *Administrative, Nondispositive Provisions*

Perhaps the most significant change in 2005 was to permit “administrative, nondispositive” provisions to be modified upon a showing that the change is “necessary or appropriate to prevent waste or avoid impairment of the trust’s administration.” Note that this finding is not based on the apparent or supposed intention of the settlor. Rather, it focuses on the efficient administration of the trust regardless of the intent of the settlor.

What is an administrative, nondispositive provision? The author believes this includes most investment restrictions (for example, “don’t sell Blackacre,” “invest only in New York Stock Exchange stocks,” etc.), choice of law provisions and provisions affecting administration and management powers. With respect to provisions requiring the retention of specific assets, one might argue that the provision is “dispositive” and, therefore, not subject to change under Section 1123.054(a)(3), if the purpose of the restriction was to assure that the specific asset passed to the remainder beneficiaries. However, in most cases, this is a convenient way for a trustee to seek to free itself of restrictions which make it difficult or impossible to comply with the new prudent investor standard.

Other administrative, nondispositive changes are changing the manner of selecting new trustees, changing the required qualifications of trustees (for example, eliminating the requirement of a corporate trustee) and changing the governing law of the trust to another state.

4. *Necessary to Achieve Tax Objectives or to Qualify Distributee for Governmental Benefits*

Section 112.054(a)(4) permits retroactive modification of provisions if necessary or appropriate to achieve the settlor’s tax objectives or to qualify a distributee for governmental benefits in a way which is not contrary to the settlor’s intentions. The retroactive feature for modifications is welcome but may not be binding on the IRS. A reformation action under Section 112.054(b-1)(2) or 112.054(b-1)(3) may be the best way to fix a trust to achieve the settlor’s tax objectives. Section 112.054(b-1)(3) is particularly helpful to address a scrivener’s error causing a tax problem (e.g., a crummey power that does not work).

³³ 432 S. W. 3d at 367.

5. *Modification or Termination with Beneficiary Consent*

Section 112.054(a)(5) permits termination of a trust upon a finding that “continuance of the trust is not necessary to achieve any material purpose of the trust” if, but only if, all beneficiaries agree. Similarly, the subsection permits modification of a trust if the change “is not inconsistent with a material purpose of the trust” if, but only if, all beneficiaries agree. Consent of minor, incapacitated, unborn or unascertained beneficiaries may be obtained using virtual representation concepts or by appointment of a guardian ad litem.³⁴

A. *Findings Required Under Current Statute – Subsection (b-1)*

Under Section 112.054(b-1), added in 2017, a trust may be reformed if:

- (1) reformation of administrative, nondispositive terms of the trust is necessary or appropriate to prevent waste or impairment of the trust's administration;
- (2) reformation is necessary or appropriate to achieve the settlor's tax objectives or to qualify a distributee for governmental benefits and is not contrary to the settlor's intentions; or
- (3) reformation is necessary to correct a scrivener's error in the governing document, even if unambiguous, to conform the terms to the settlor's intent.

Section 112.054(e) requires reformation due to scrivener's error to be established by clear and convincing evidence.

Subsection (f) was added to make clear that Subsection (b-1) is not intended to state the exclusive basis for reformation of trusts. Rather, the bases for reformation of trust in equity or common law are not affected by Section 112.054.³⁵

Following is a discussion of each of these bases for reforming a trust under Section 112.054(b-1):

1. *Administrative, Nondispositive Provisions*

Section 112.054(b-1)(1) permits reformation of “administrative, nondispositive” provisions upon a showing that the change is “necessary or appropriate to prevent waste or avoid impairment of the trust's administration.” Note that this finding is not based on the apparent or

³⁴ Tex. Trust Code §112.054(d).

³⁵ See “*Equitable Reformation and Recission*” below.

supposed intention of the settlor. Rather, it focuses on the efficient administration of the trust regardless of the intent of the settlor.

What is an administrative, nondispositive provision? The author believes this includes most investment restrictions (for example, “don’t sell Blackacre,” “invest only in New York Stock Exchange stocks,” etc.), choice of law provisions and provisions affecting administration and management powers. With respect to provisions requiring the retention of specific assets, one might argue that the provision is “dispositive” and, therefore, not subject to change under Section 1123.054(a)(3), if the purpose of the restriction was to assure that the specific asset passed to the remainder beneficiaries. However, in most cases, this is a convenient way for a trustee to seek to free itself of restrictions which make it difficult or impossible to comply with the new prudent investor standard.

Other administrative, nondispositive provisions are the manner of selecting new trustees, the required qualifications of trustees (for example, eliminating the requirement of a corporate trustee) and the governing law of the trust.

2. *Necessary to Achieve Tax Objectives or to Qualify Distributee for Governmental Benefits*

Section 112.054(b-1)(2) permits reformation of provisions if necessary or appropriate to achieve the settlor’s tax objectives or to qualify a distributee for governmental benefits in a way which is not contrary to the settlor’s intentions.

3. *Correct Scrivener’s Error*

Section 112.054(b-1)(3) permits reformation “if necessary to correct a scrivener’s error in the governing document, even if unambiguous, to conform the terms to the settlor’s intent.” Reformation on this basis is permitted only if supported by clear and convincing evidence of the settlor’s intent.³⁶

3.2.6. *Conforming to the Intent of the Settlor*

Tex. Trust Code §112.054(b) directs the court to exercise its discretion “to order a modification or termination under Subsection (a) or reformation under Subsection (b-1) in the manner that conforms as nearly as possible to the *probable* intention of the settlor.” The word “probable” was added to Subsection (b) by the 2005 changes. Obviously, if the modification is needed because of a circumstance truly unanticipated by the settlor, it is hard to prove what the settlor intended with respect to that circumstance. Lowering the standard to the “probable” intention makes it easier to meet.

³⁶ Tex. Trust Code §112.054(e).

Two things about this requirement are important to note:

First, it applies only to “modification or termination” orders under Section 112.054(a) or reformations under Subsection (b-1). It does *not* apply to reformations under equitable or common law principles which are permitted under Subsection (f). Does it apply to the other actions permitted by Section 112.054(a), such as changing trustees, ordering the trustee to do something prohibited by the trust instrument or prohibiting the trustee from doing something required by the trust instrument? One can argue that the intentions of the settlor are less important to these actions permitted by Section 112.054(a), so the drafters of the legislation intended to make this requirement applicable only to modifications or terminations. After all, changing trustees or directing or prohibiting an action specifically addressed in the trust instrument necessarily requires the court to go against the stated intention of the settlor. On the other hand, it seems possible that “modification or termination” was just a shorthand way of saying the five actions permitted under Section 112.054(a), and the intention of the settlor is important with respect to all such actions.

Second, while this requires the court to conform “as nearly as possible” with the settlor’s probable intention, implicit in Section 112.054 is the concept that *some* departure from the settlor’s probable intention is permitted, if not required. It makes no sense to have a statute on modifying, terminating or reforming trusts if the court cannot veer away from the settlor’s intention at least to some degree.

A case decided on the law that existed prior to 2005, *Conte v. Ditta*³⁷ used this provision to limit the scope of a trial court’s modification of a trust. The trust instrument provided that a beneficiary (who also was the trustee) had the power to appoint a successor trustee, and if that beneficiary could not do it, the adult beneficiaries (including the beneficiary/trustee) had the power. The trial court removed the beneficiary/trustee. The court also modified the trust to provide that the court, not the trustee/beneficiary and not the adult beneficiaries, had the power to appoint the successor trustee. The court believed that it would be “impractical, inexpedient and would substantially impair the accomplishment of the purposes of the trust” to permit the beneficiary/trustee or the adult beneficiaries to appoint the successor. The appellate court agreed that the trust terms should be modified to prohibit the removed trustee from appointing her successor, but it said the trial court failed to make the modified terms conform as nearly as possible to the intention of the settlor by giving itself the power to appoint a successor trustee. The settlor had expressed a clear intention that the beneficiaries should be allowed to name a successor, so the modification needed to conform as nearly as possible to this intention.³⁸

³⁷ 312 S. W. 3d 951 (Tex. App. – Houston (1st Dist.) 2010).

³⁸ 312 S. W. 3d at 960.

3.2.7. *Spendthrift Clauses are a Factor But Not an Impediment*

Section 112.054(b) provides in part:

The court shall consider spendthrift provisions as a factor in making its decision whether to modify, terminate or reform, but the court is not precluded from exercising its discretion to modify or terminate solely because the trust is a spendthrift trust.

Most irrevocable trusts include spendthrift provisions — provisions which prohibit a beneficiary from anticipating his or her receipt of trust property and which prohibit a beneficiary's creditors from attaching the beneficiary's interest in the trust. These provisions are at least some indication that the settlor did not want the beneficiaries to have the power to deal with and/or receive the trust property prior to the time for distribution under the trust instrument. Thus, absent some mention of the effect of a spendthrift clause in a modification or termination statute, a court might find that the inclusion of a spendthrift provision by itself is a sufficient reason not to modify or terminate a trust if the effect of the modification or termination would be to accelerate the receipt of trust property by one or more beneficiaries.

Of course, in most cases spendthrift clauses are included as part of the administrative provisions of a trust, rather than as an integral part of the trust's dispositive provisions. When administrative provisions conflict with the dispositive or beneficial provisions, in general the administrative provision must yield.³⁹

Section 112.054(b) wisely provides that the court should consider the spendthrift provision as a factor, but that the inclusion of the spendthrift provision is not an automatic bar to modification, termination or reformation. In some cases, the court's consideration of the spendthrift provision may lead it to conclude that acceleration of distributions to beneficiaries runs counter to the settlor's primary intent and would necessarily frustrate the settlor's purposes in setting up the trust. In other cases, the court may conclude that the spendthrift provision was included for prophylactic creditor protection or for other, relatively insignificant reasons, so the spendthrift provisions should not impede the modification or termination for other, more pressing reasons.

Note that the provision regarding spendthrift trusts in Section 112.054(b) speaks in terms of the court's discretion to "modify," "terminate" or "reform" a trust, not its discretion regarding changing trustees, ordering the trustee to do something prohibited by the trust instrument or prohibiting the trustee from doing something required by the trust instrument — the other actions permitted under Section 112.054(a).

³⁹ See Bogert, *Trusts and Trustees* (2nd Ed. Rev.), §561.

3.2.8. No Justiciable Controversy Required

Proceedings under Tex. Trust Code §112.054 do not require a justiciable controversy.⁴⁰ Therefore, a modification, termination or reformation suit is not subject to attack merely because there is no actual controversy before the court.

3.3. Equitable Reformation and Recission

Section 112.054(f), added in 2017, makes clear that Section 112.054(b-1) is not intended to state the exclusive basis for reformation of trusts, and the bases for reformation of trusts in equity or common law are not affected by Section 112.054.

Reformation suits are kin to modification and termination suits, but the basis for the suit is different. Reformation suits are based on mistakes of fact at the inception of the trust, not deviation from the trust terms due to changed circumstances. If, due to a mistake in the drafting of the trust instrument, the instrument does not contain the terms of the trust as intended by the settlor and trustee, the settlor or other interested party may maintain a suit in equity to have the instrument reformed so that it will contain the terms which were actually agreed upon.⁴¹

Reformation based on mistake must be based on a mistake of fact, not a mistake of law.⁴² However, while the general rule is well settled that a court will not relieve against a mistake of law, it is also generally held that such rule is confined to mistake of the general rules of law, and has no application to the mistake of persons as to their own private legal rights and interests, so that, if parties contract under a mutual mistake and misapprehension as to such rights, the result is that the agreement is liable to be set aside as having proceeded upon a common mistake.⁴³ In *Furnace v. Furnace*, for example, the parties were mistaken as to what effect a sale would have on their interests in a trust. Dicta in the opinion indicates that this was a mistake of fact, not of law, even though legal interpretations of instruments were involved. (Despite the dicta, the court of appeals in *Furnace* found that the parties waived this issue by failing to submit it at trial.)

A recent trend in cases is to permit reformation of the trust to achieve the clearly expressed intent to save transfer taxes even though the instrument would otherwise fail to achieve that intent. For example, if the settlor's intent to save generation-skipping taxes is clearly stated in the trust instrument, the dispositive provisions of the trust may be reformed where necessary to effectuate such intent.⁴⁴ However, in one case applying Texas law, reformation was denied where the

⁴⁰ *Gregory v. MBank Corpus Christi, N.A.*, 716 S.W.2d 662 (Tex. App.--Corpus Christi 1986, no writ).

⁴¹ Bogert, *Trusts and Trustees* (2nd Ed. Rev.), §991.

⁴² *Community Mut. Ins. Co. v. Owen*, 804 S.W.2d 602 (Tex. App.-Houston (1st Dist.) 1991, writ denied).

⁴³ *Furnace v. Furnace*, 783 S.W.2d 682, 686 (Tex. App.-Houston (14th Dist.) 1989, writ dismissed w.o.j.).

⁴⁴ *Loeser v. Talbot*, 589 N. E. 2d 301, 412 Mass. 361 (1992).

alleged mistake as to tax consequences was not the overriding reason for the trust. In *duPont v. Southern National Bank of Houston*,⁴⁵ the court found that there was insufficient evidence that the settlor would not have created the trust but for his alleged mistake as to tax consequences. The court apparently believed that the primary purpose of the trust was to keep property from his wife, not tax savings.⁴⁶

Tex. Trust Code §112.036 expressly permits reformation of a trust which would otherwise violate the rule against perpetuities.

If a settlor never intended to create a trust, then rescission is the proper remedy. In *Wils v. Robinson*,⁴⁷ the court of appeals found that Section 112.054(a)(2) was not a basis for terminating a trust which the settlor said he never intended to create; rather, rescission was the proper remedy, based on mistake, fraud, duress or undue influence.⁴⁸ Despite the result in *Wils*, the prudent course is to plead and attempt to prove modification and termination under Section 112.054 as an alternative theory when rescission is a possible theory.

3.4. *Jurisdiction*

3.4.1. *District Court and Statutory Probate Court*

A district court and a statutory probate court have jurisdiction over trust matters.⁴⁹ A suit to modify or terminate a trust safely may be brought in a district court or a statutory probate court.

3.4.2. *County Court at Law*

A statutory county court other than a statutory probate court (a “county court at law”) has the jurisdiction over a matter involving “the interpretation and administration of a testamentary trust if the will creating the trust has been admitted to probate in the court” and “the interpretation and

⁴⁵ 575 F. Supp. 849 (S. D. Texas 1983), affirmed in part, vacated in part, on other issues 771 F. 2d 849 (5th Cir. 1985), cert. denied 475 U. S. 1085 (1986).

⁴⁶ Section 112.054(a)(4), which permits modification of a trust if “necessary or appropriate to achieve the settlor’s tax objectives,” is another basis for addressing this issue. See “Necessary to Achieve Tax Objectives” above. See also “Possible 2017 Legislation” above.

⁴⁷ 934 S.W.2d 774 (Tex. App.-- Houston. (14th Dist.) 1996, writ granted), judgment vacated without reaching merits 938 S.W.2d 717 (Tex. 1997).

⁴⁸ 934 S. W. 2d at 779.

⁴⁹ Tex. Trust Code §115.001; Tex. Est. Code §§31.002, 32.006 and 32.007.

administration of an inter vivos trust created by a decedent whose will has been admitted to probate in the court.”⁵⁰

It would be great if Section 31.002(b) addressed jurisdiction in broader terms or contained a laundry list of matters over which county courts at law had trust jurisdiction.⁵¹ It does not, however, so until there is an appellate case on the point, a practitioner is stuck interpreting this language. A county court at law did not have jurisdiction over trusts prior to 2011. When Section 4B of the Texas Probate Code (the predecessor of Section 31.002 of the Estates Code) was enacted in that year, the clear intention was to avoid the need for two proceedings – a probate proceeding in the county court at law and a trust proceeding in the district court – when an issue involving a trust arose during the probate administration. Since one of the most common issues to arise is the need to modify a trust, the author thinks this change was intended to include modifications and terminations of trusts. At many levels, the termination or modification of a trust involves the “administration” of that trust. Still, the statute is not as clear as it could be.

Under Section 31.002(b), the county court at law has jurisdiction over a testamentary trust if the will creating the trust was probated in that court and over an inter vivos trust if the settlor’s will was probated in that court, regardless of how long after the probate proceeding the suit involving the trust is commenced.

3.4.3. *Court-Created Trusts*

The court creating a guardianship management trust under Chapter 1301 of the Estates Code retains the jurisdiction to modify or terminate that trust even if it is not a statutory probate court or a county court at law.⁵² Similarly, the court which creates a trust under Section 142.005 of the Property Code retains jurisdiction to modify or terminate that trust.⁵³

3.5. *Venue*

Venue of a trust action is based on Section 115.002 of the Trust Code.

If there is a single, noncorporate trustee, venue is proper in the county where the trustee resides or has resided at any time during the four-year period preceding the date the action is filed. Venue also is proper in the county where the situs of administration is maintained or has been maintained at any time during the four-year period preceding the date the action is filed.

⁵⁰ Tex. Est. Code §31.002(b).

⁵¹ See, for example, Tex. Trust Code §115.001.

⁵² Tex. Est. Code §1301.201.

⁵³ Tex. Prop. Code §142.005(d).

If there are multiple trustees none of whom is a corporate trustee, venue is proper in a county where any of the trustees resides or has resided in the last four years, as well as in the county where the situs of administration is maintained or has been maintained in the last four years. If the multiple trustees maintain a principal office in Texas, venue also is proper where the trustees maintain the principal office.

If there are one or more corporate trustees, venue is proper where the situs of administration is maintained or has been maintained at any time during the four-year period preceding the date the action is filed. Venue also is proper where any corporate trustee maintains its principal office in Texas.

Notwithstanding these provisions, if the settlor is deceased and the administration of his or her estate is pending in Texas, “an action involving the interpretation and administration of” an inter vivos trust or testamentary trust created by the settlor may be brought in the county in which the administration of the settlor’s estate is pending.

Keep in mind that, while jurisdiction is a mandatory requirement, venue is permissive. A judgment in a court without jurisdiction is void or voidable, but a judgment in a court with jurisdiction but without proper venue is valid and enforceable. Therefore, it is possible to file a friendly suit (or an unfriendly suit, for that matter, so long as no one objects to venue) in a county where venue is improper if that location is more convenient for the parties.

3.6. Parties to Termination/Modification/Reformation Suit

3.6.1. Who May Initiate Suit

As noted above, Section 112.054(a) and (b-1) of the Trust Code provides that a trustee or a beneficiary may commence an action under that section, while Section 115.011(a) provides that any “interested person” may commence an action under Section 115.001, the general jurisdictional statute. This inconsistency makes it unclear whether an “interested person” who is not a trustee or beneficiary (for example, the settlor) may initiate a modification or termination suit.

The definition of “interested person” in Section 111.004(7) was amended in 1995 in response to at least one case at the trial court level in which the court determined that a beneficiary was not an “interested person” and, therefore, could not initiate an action under Section 115.001. That should not be a problem with an action under Section 112.054, since that section specifically authorizes a beneficiary to bring the action. Nonetheless, the 1995 amendment to Section 111.004(7) makes it clear that, while a trustee or a beneficiary always is an “interested person,” whether a person other than a trustee or a beneficiary is an “interested person” for purposes of bringing a trust code action “may vary from time to time and must be determined according to the particular purposes of and matter involved in any proceeding.” Among those persons who have been found to not be “interested persons” were a father of minor beneficiaries seeking to

compel an accounting or remove a trustee,⁵⁴ and the settlor's wife, who was not a trustee, was not a beneficiary, did not stand to inherit any trust assets, and had no community property interest in corpus or undistributed income of trust.⁵⁵

3.6.2. *Necessary and Proper Parties*

Often the most difficult problem facing an attorney seeking to judicially modify, terminate or reform a trust is determining which parties are necessary parties and which are merely proper parties. The vast majority of trusts have potential contingent beneficiaries who are unknown, undeterminable or suffering a legal disability such as minority. If these persons are necessary parties, then a guardian ad litem usually will be necessary to fully resolve the proceeding. If, on the other hand, these persons merely are proper parties, it may be unnecessary to have an ad litem.

The Trust Code attempts to bring some clarity to the issue of necessary versus proper parties. Tex. Trust Code §115.011(b) starts out by stating plainly that contingent beneficiaries designated as a class are not necessary parties. It then provides that the only necessary parties are:

- (1) A beneficiary of the trust on whose act or obligation the action is predicated;
- (2) A beneficiary of the trust designated by name, other than a beneficiary whose interest has been distributed, extinguished, terminated, or paid;
- (3) A person who is actually receiving distributions from the trust estate at the time the action is filed; and
- (4) The trustee, if a trustee is serving at the time the action is filed.

In the case of a charitable trust, §115.001(c) provides that the attorney general shall be given notice of any proceeding as provided in Chapter 123 of the Property Code. That chapter gives the attorney general the opportunity to intervene if he sees fit.

A beneficiary who first raises the modification, termination or reformation issue with the trustee (the instigator, so to speak) probably is a necessary party under subparagraph (1) of Section 115.011(b).

Subsections (1) and (2) were amended in 2001 to make clear that they apply only to beneficiaries *of the trust*, not beneficiaries of other gifts or trusts under the will or trust instrument. The 2011 amendment also excluded as necessary parties any beneficiary whose interest has been fully

⁵⁴ *Davis v. Davis*, 734 S. W. 2d 707 (Tex. App. — Houston (1st Dist) 1987, writ ref'd, n. r. e.).

⁵⁵ *Lemke v. Lemke*, 929 S.W.2d 662 (Tex. App. -- Fort Worth 1996, writ denied).

distributed or paid. Thus, the trustee can avoid having a nuisance beneficiary in the lawsuit if the trustee is able to fully distribute his or her interest.

What does “*actually* receiving distributions . . . at the time the action is filed” mean? It cannot be limited to beneficiaries actually receiving distributions at the instant the lawsuit is filed, for this would usually yield no necessary parties. At the other extreme, it apparently does not mean persons to whom distributions are possible at the time the suit is filed — for example, descendants of the primary beneficiary in cases where the trustee holds a spray power. The more probable middle ground includes each person who has received distributions from the trust and whose basis for receiving those distributions has not terminated. Avoiding unnecessary “necessary” parties is a good reason to avoid routinely including spray powers in bypass trusts.⁵⁶

3.6.3. *Virtual Representation and Related Issues*

Sometimes it is impossible to get all beneficiaries before the court due to the status of some of the beneficiaries. Beneficiaries who are minors, incapacitated, unborn or unascertained cannot themselves participate in a judicial modification, termination or reformation proceeding. Trustees and other persons interested in the trust understandably are reluctant to take actions involving the trust which do not bind these other beneficiaries.

Of course, one alternative is to have a guardian of the estate or a guardian ad litem appointed for such persons. Tex. Trust Code §115.014(a) authorizes the court to appoint one or more guardians ad litem if the court determines that the representation of those persons’ interests otherwise would be inadequate. Tex. Trust Code §115.013(c)(2)(A) provides that, to the extent there is no conflict of interest between the guardian ad litem and the persons represented, an order binding the guardian ad litem binds the “ward.”

In 2005, Subsection (c) was added to Section 115.014 of the Trust Code, permitting a guardian ad litem to “consider general benefit accruing to the living members of a person’s family” in deciding how to act. This makes it easier to obtain guardian ad litem approval to a modification that provides no direct benefit to minor or unascertained beneficiaries but which benefits the family (and, presumably, the minor or unascertained members of the family) generally.

In 2009, Subsection (b) was added to Section 115.014 permitting a court to appoint an *attorney* ad litem “to represent any interest that the court considers necessary.” This may be helpful if there is a broad category of beneficiaries to be represented, not just minor, incapacitated, unborn or unascertained beneficiaries. Typically this is not going to be the case. If it is possible to appoint a guardian ad litem to represent the missing beneficiaries, it is preferable to do so since a

⁵⁶ For others, see the author’s paper “Protecting the Surviving Spouse and Protecting Yourself After *Belt v. Oppenheimer*” at <http://texasprobate.com/download-cle-articles/protect.pdf>.

guardian ad litem may consider general benefit accruing to the living members of a person's family while an attorney ad litem may not.⁵⁷

There is another way to bind minors, unborn and unascertained beneficiaries in some cases – virtual representation. The doctrine of virtual representation exists at common law independent of statute.⁵⁸ In addition, the doctrine has been codified in Section 115.013(c) of the Trust Code.⁵⁹

Under Section 115.013(c), if there is no conflict of interest and no guardian of the estate or guardian ad litem has been appointed, a parent may represent his minor child as guardian ad litem or as next friend. Also, an unborn or unascertained person who is not otherwise represented is bound by an order to the extent his interest is adequately represented by another party having a substantially identical interest in the proceeding.

While this statutory statement of virtual representation is limited to parents acting for their minor children and other beneficiaries acting for unborn or unascertained persons, the cases applying the common law virtual representation doctrine do not appear to limit virtual representation to minors and unborn persons.⁶⁰ Also, *Mason v. Mason*⁶¹ makes clear that the common law doctrine of virtual representation is not limited to beneficiaries representing other beneficiaries. In *Mason*, it was the trustee who was found to have virtually represented the beneficiaries in a suit challenging the validity of the trust.

Normally, only parties may appeal a judgment. An exception exists for persons represented in a case by virtual representation. Even though they are not actually joined in a proceeding and made an actual party, they probably have the right to appeal the judgment — they may be bound by the judgment when it becomes final, but they have an independent right to appeal it before it becomes final.⁶² This right of appeal should be factored into the parties' decision about when it is appropriate to make distributions following a judicial modification or termination — better to wait until the judgment becomes final and binding on virtually represented parties before doling out the money.

⁵⁷ See Tex. Trust Code §115.014(c).

⁵⁸ See, for example, *Mason v. Mason*, 366 S.W.2d 552 (Tex. 1963); *Starcrest Trust v. Berry*, 926 S.W.2d 343 (Tex. App. --Austin, 1996); *Hedley Feedlot, Inc. v. Weatherly Trust*, 855 S.W.2d 826 (Tex. App.--Amarillo 1993, no writ); and *Citizens State Bank v. Bowles*, 663 S.W.2d 845 (Tex. App.--Houston [14th Dist.] 1983, writ dism'd).

⁵⁹ See also Tex. Trust Code §114.032 and “The Nonjudicial Virtual Representation Statute” below.

⁶⁰ See, e.g., *Mason v. Mason*, 366 S.W.2d 552 (Tex. 1963).

⁶¹ 366 S.W.2d 552 (Tex. 1963).

⁶² See *American Physicians Insurance Exchange v. Cardenas*, 717 S. W. 2d 707 (Tex. App. -- San Antonio 1986, writ ref'd, n. r. e.); *Grohn v. Marquardt*, 487 S.W.2d 214 (Tex. Civ. App.--San Antonio 1972, writ ref'd n.r.e.).

If a beneficiary is not a necessary party under Section 115.011, and if he or she is not represented in the proceeding by a guardian, a guardian ad litem or by virtual representation, that beneficiary is not bound by the judgment.

3.6.4. Analysis of Necessary Parties, Virtual Representation, and Ad Litem Requirements in Modification and Termination Proceedings

The virtual representation statute (Section 115.013(c)) and the necessary parties statute (Section 115.011) provide a safe harbor in most cases where trust modification or termination is sought — if all of the necessary parties described in Section 115.011 can be served or otherwise brought into the suit, if all minors can be represented by their parents without a conflict of interest, and if the interests of all unborn or unascertained persons are adequately represented by another party having a substantially identical interest, then a guardian ad litem generally can be avoided and the parties can have a moderate level of comfort that the modification or termination order will be binding on all beneficiaries. If some or all of these requirements cannot be met, then one or more ad litems probably are necessary under Section 115.014.

It is useful to examine these factors in the following hypothetical:

Virtual Representation Hypothetical

Assume Settlor S creates an irrevocable trust with T as trustee, income to I for life, remainder to R on the death of I, or to R's descendants per stirpes if R predeceases I. None of R's descendants are adults.

Example 1: Assume I and R are adults with capacity. T wishes to modify the trust to invest in equities. (S required the investment in FDIC-insured accounts only, but T believes S could not have anticipated the circumstances now presented, with low interest rates on accounts and high return on equities.)

T and I are necessary parties. R is not a necessary party (unless R is the beneficiary "on whose act or obligation the action is predicated"), but R will not be bound by the judgment unless R is made a party or is virtually represented. Therefore, R must be made a party. R can virtually represent his minor children (there's no conflict of interest, since R's interest is identical to those of his children on this issue), and R can virtually represent unborn and unascertained persons (he can adequately represent their interest, and they have a substantially identical interest with R).

Example 2: Assume I is an adult with capacity, while R is I's minor child. T wishes to modify the trust to invest in equities.

T and I are necessary parties. R is not a necessary party (unless R is the beneficiary "on whose act or obligation the action is predicated"), but R will not be bound by the judgment unless R is made a party or is virtually represented. I cannot virtually represent R, however, since there is a conflict of interest. (Investment in equities affects the income interest and the remainder interest differently.) Also, I's interest is not substantially identical to that of R's descendants, so I cannot virtually represent those unborn or unascertained persons. A guardian ad litem is needed for R, R's descendants and unborn and unascertained persons, but only one ad litem ought to be needed, since the interests of R, R's descendants and unborn and unascertained persons are identical.

Virtual Representation Hypothetical

Assume Settlor S creates an irrevocable trust with T as trustee, income to I for life, remainder to R on the death of I, or to R's descendants per stirpes if R predeceases I. None of R's descendants are adults.

Example 3: Assume I and R are adults with capacity. I wants to terminate the trust early and have all of the trust property distributed to I. R is willing to agree, and T is willing to permit the termination if a court orders it.

T and I are necessary parties. R is not a necessary party (unless R is the beneficiary "on whose act or obligation the action is predicated"), but R will not be bound by the judgment unless R is made a party or is virtually represented. Therefore, R must be made a party. In theory, at least, R can virtually represent his minor children, since there's no conflict of interest and since R's interests are identical to those of his children on this issue. Similarly, in theory, at least, R can virtually represent unborn and unascertained persons (he can adequately represent their interest, and they have a substantially identical interest with R). In reality, however, it is not clear that virtual representation would bind R's descendants, since R is basically giving up the store — yes, his interests are identical, but he's doing nothing to protect those interests. The minute the termination is approved, his interests and those of his descendants go away. A guardian ad litem may be needed. The guardian ad litem may determine that, notwithstanding that R's descendants get nothing directly from this plan, it nevertheless may be beneficial to R's descendants because there will be less money eaten up in trust fees and R's descendants may eventually get something.

Example 4: Assume I and R are adults with capacity. I wants to terminate the trust early and have part of the trust property distributed to I and part of the trust property distributed to R. R is willing to agree, and T is willing to permit the termination if a court orders it.

T and I are necessary parties. R is not a necessary party (unless R is the beneficiary "on whose act or obligation the action is predicated"), but R will not be bound by the judgment unless R is made a party or is virtually represented. Therefore, R must be made a party. R cannot virtually represent his minor children or other descendants, since there's a conflict of interest -- under the plan, R gets part of the trust property and R's descendants do not. A guardian ad litem is needed. The guardian ad litem may determine that, notwithstanding that R's descendants get nothing directly from this plan, it nevertheless may be beneficial to R's descendants because there will be less money eaten up in trust fees and R's descendants may eventually get something.

Virtual Representation Hypothetical

Assume Settlor S creates an irrevocable trust with T as trustee, income to I for life, remainder to R on the death of I, or to R's descendants per stirpes if R predeceases I. None of R's descendants are adults.

Example 5: Assume I and R are adults with capacity. I wants to terminate the trust early and have part of the trust property distributed to I and part of the trust property distributed to R. R is willing to agree, but T is unwilling to consent. T will agree to have the trust modified so that noncorporate trustees are permitted and I becomes the trustee. I and R agree to proceed with this modification rather than the termination.

T and I are necessary parties. R is not a necessary party (unless R is the beneficiary "on whose act or obligation the action is predicated"), but R will not be bound by the judgment unless R is made a party or is virtually represented. Therefore, R must be made a party. R can virtually represent his minor children (there's no conflict of interest, since R's interest is identical to those of his children on the modification issue), and R can virtually represent unborn and unascertained persons (he can adequately represent their interest, and they have a substantially identical interest with R on the modification issue).

Example 6: Assume I and R are adults with capacity. T, I and R agree to have the trust modified so that noncorporate trustees are permitted and I becomes the trustee. Shortly after the judicial modification, I, as trustee, distributes all of the trust property to I and R.

T and I are necessary parties. R is not a necessary party (unless R is the beneficiary "on whose act or obligation the action is predicated"), but R will not be bound by the judgment unless R is made a party or is virtually represented. Therefore, R must be made a party. If the post-modification distributions were not prearranged, R presumably can virtually represent his minor children (there's no conflict of interest, since R's interest is identical to those of his children on the modification issue), and R can virtually represent unborn and unascertained persons (he can adequately represent their interest, and they have a substantially identical interest with R on the modification issue). However, the deal looks fishy, and R's descendants might have a basis to complain about I's and R's actions upon attaining majority.

4. Nonjudicial Modification or Termination

In many cases, it may not be necessary to resort to a judicial proceeding to modify or terminate a trust.⁶³

4.1. Actions Permitted by the Trust Instrument

Clearly, the best way to modify or terminate a trust nonjudicially is to do so in accordance with the trust instrument. Therefore, the drafter of the trust instrument can do a lot to make life easier — or harder — for trustees or beneficiaries who later want to modify or terminate the trust.

⁶³ Of course, the trustee may wish to get the court's blessing to the modification or termination in some cases even if there is a nonjudicial basis for modification or termination.

Many trusts include provisions which expressly permit the trustee or others to modify or terminate the trust in certain circumstances. Some modification or termination provisions are quite broad, but care must be taken not to give the person holding the power to modify or terminate a general power of appointment for federal gift and estate tax purposes. See “Drafting with the Future in Mind” above for tips on including provisions promoting flexibility.

Even if the trust instrument does not include an express modification or termination provision, the trustee may be able to terminate a trust by distributing the remaining assets pursuant to a facility of payment provision. Tex. Trust Code §113.021 provides a rudimentary facility of payment provision for trusts with no broader express provision. It permits the trustee to make a distribution required or permitted to be made to a minor or incapacitated beneficiary in one of several ways, including to a custodian under the Uniform Transfers to Minors Act. Of course, a well-drafted trust usually has a much broader facility of payment provision which, for example, may not be limited to minors or incapacitated persons. These provisions can provide the means for getting property out of a cumbersome, expensive trust into a form that is more beneficial to the beneficiary.

4.2. Termination and Modification Permitted by Statute

Even if the trust instrument contains no provision authorizing modification or termination of the trust, the Trust Code may contain a provision that makes it possible to accomplish the same purpose.

4.2.1. Revocation by Settlor

Unlike most states, in Texas a trust is revocable by the settlor unless it is irrevocable by the express terms of the instrument.⁶⁴ The trust instrument should be examined for an express irrevocability clause. If the trust is revocable, then of course the settlor can terminate it and modify it at will, provided that the settlor cannot enlarge the trustee’s duties without the trustee’s consent.⁶⁵

4.2.2. Termination by Occurrence of Event

Although it almost goes without saying, a trust terminates if by its terms the trust is to continue only until the expiration of a certain period or until the happening of a certain event and the period of time has elapsed or the event has occurred.⁶⁶

⁶⁴ Tex. Trust Code §112.051.

⁶⁵ Tex. Trust Code §112.051.

⁶⁶ Tex. Trust Code §112.052.

4.2.3. *Merger*

Tex. Trust Code §112.034 is a codification of the doctrine of merger. It provides that a settlor does not create a trust if he retains both legal title and all equitable interests or if he transfers both legal title and all equitable interests to the same person. Also, Section 112.034 provides that a trust terminates if the legal title to the trust property and all equitable interests (other than a settlor's beneficial interest protected under a spendthrift trust) in the trust become united in one person. This doctrine rarely applies with most modern trusts (or attempts at trust) since there usually is one or more remainder beneficiaries other than the settlor.

4.2.4. *Division and Combination of Trusts*

Section 112.057 of the Trust Code permits the trustee to divide a trust into two or more separate trusts or combine two or more trusts into a single trust without a judicial proceeding "if the result does not impair the rights of any beneficiary or adversely affect achievement of the purposes" of the original trust or trusts. Combining two trusts under Section 112.057 can be superior to decanting under the Texas decanting statutes.⁶⁷

4.2.5. *Decanting*

In 2013, the legislature added Subchapter D to Chapter 112 of the Trust Code, entitled "Distribution of Trust Principal in Further Trust." These 17 sections bring decanting to Texas for trusts with no express decanting provision. Decanting permits the trustee of a trust to transfer ("decant") the property from that trust to another trust under certain circumstances. While this is not a modification of the transferring trust, as a practical matter the terms of the transferring trust are modified to match the terms of the receiving trust, since the receiving trust's instrument will thereafter govern the trust.

The Texas statute contains many limitations on the power to decant. Like most of the Trust Code, the decanting statutes establish default rules. A settlor may include specific decanting provisions in the trust instrument which control over the statutory provisions.

Under the current Texas statute, it is virtually impossible to use decanting to change dispositive provisions of a trust unless the trust is a "full discretion" trust. A change in 2017 makes the decanting statute much more usable. Now a "full discretion" trust means a trust that is not a trust with "limited discretion." The definition of a "limited discretion" trust was changed in 2017 to mean a trust where the trustee has "a power to distribute principal according to mandatory distribution provisions under which the trustee has no discretion" or "a power to distribute principal to or for the benefit of one or more beneficiaries of a trust that is *limited by an ascertainable standard, including the health, education, support, or maintenance of the*

⁶⁷ (Tex. Trust Code §§ 112.071-112.087).

*beneficiary.*⁶⁸ Decanting by a trustee of a “limited discretion” trust requires the receiving trust to have the same current beneficiaries, the same remainder beneficiaries, the same distribution language and the same power of appointment terms.⁶⁹ The 2017 change increases the number of trusts which are “full discretion” trusts since any trust that does not require mandatory principal distributions or principal distributions limited by an ascertainable standard is a “full discretion” trust.

Another 2017 change also makes it easier to use the Texas decanting statutes. Prior to 2017, a trustee could not decant if doing so would “materially impair the rights of any beneficiary of the trust,” whether or not the trust is a full discretion or limited discretion trust.⁷⁰ That restriction was removed in 2017.

There are several restrictions and requirements for decanting under the Texas statute. For a full discussion of decanting, including current Texas requirements, *see* Melissa Willms, “Decanting Trusts: Irrevocable Not Unchangeable,” 20th Annual Advanced Estate Planning Strategies Course (2014).

4.2.6. *Disclaimers*

The Texas Uniform Disclaimer of Property Interests Act⁷¹ permits trust beneficiaries to disclaim beneficial interests and permits trustees to disclaim property which otherwise would pass into a trust. Under the act, a disclaimer must occur prior to acceptance of the property or interest, but there is no time limit for the disclaimer. In the appropriate case, a disclaimer by the trustee or a trust beneficiary could have the effect of preventing a trust from being created.

4.2.7. *Amendment of Charitable Trusts*

Section 112.055 of the Trust Code provides for certain tax-oriented provisions to be included in a trust instrument governing private foundations and certain split-interest trusts by operation of law, while Section 112.056 permits the settlor of a trust and the trustee of a trust to consent to such amendments nonjudicially.

⁶⁸ Tex. Trust Code §112.071(5) and (6).

⁶⁹ Tex. Trust Code §112.073.

⁷⁰ Tex. Trust Code §112.085(2).

⁷¹ Chapter 240 of the Texas Property Code. For a detailed discussion of this 2015 act, see Karisch, Featherston and Jonas, “Disclaimers under the New Texas Uniform Disclaimer of Property Interests Act,” 39th Annual Advanced Estate Planning and Probate Course (2015), updated at texasprobate.com.

4.3. Termination by Agreement of Settlor and Beneficiaries

Although the beneficiaries of a spendthrift trust may not alienate or encumber their interest in the trust property, a spendthrift trust may be modified or terminated by the consent of all the parties to it. If a settlor of a trust is alive and all of the beneficiaries of an irrevocable spendthrift trust consent (and there being no incapacity to consent by any of the parties), the settlor and all of the beneficiaries may consent to a modification or termination of the trust.⁷² Texas case law appears to make no provision that the trustee consent or even be a party to the agreement to modify or terminate a spendthrift trust.

There are two serious practical impediments to terminating a trust by agreement of the settlor and all beneficiaries. First, the settlor often is dead, rendering this method ineffective. Second, the concept of virtual representation available in judicial proceedings to modify or terminate trusts is not available when terminating a trust by agreement, and in the vast majority of cases there are minor or contingent beneficiaries who cannot enter into the agreement.

4.4. The Nonjudicial Virtual Representation Statute

In 1999, Section 114.032 was added to the Texas Trust Code, to read as follows:

Sec. 114.032. LIABILITY FOR WRITTEN AGREEMENTS. (a)

A written agreement between a trustee and a beneficiary, including a release, consent, or other agreement relating to a trustee's duty, power, responsibility, restriction, or liability, is final and binding on the beneficiary and any person represented by a beneficiary as provided by this section if:

(1) the instrument is signed by the beneficiary;

(2) the beneficiary has legal capacity to sign the instrument; and

(3) the beneficiary has full knowledge of the circumstances surrounding the agreement.

(b) A written agreement signed by a beneficiary who has the power to revoke the trust or the power to appoint, including the power to appoint through a power of amendment, the income or principal of the trust to or for the benefit of the beneficiary, the beneficiary's creditors, the beneficiary's estate, or the creditors of the beneficiary's estate is final and binding on any person who

⁷² *Musick v. Reynolds*, 798 S.W.2d 626 (Tex. App.--Eastland 1990, no writ); *Becknal v. Atwood*, 518 S.W.2d 593 (Tex. Civ. App.--Amarillo 1975, no writ); and *Sayers v. Baker*, 171 S.W.2d 547 (Tex. Civ. App.--Eastland 1943, no writ).

takes under the power of appointment or who takes in default if the power of appointment is not executed.

(c) A written instrument is final and binding on a beneficiary who is a minor if:

(1) the minor's parent, including a parent who is also a trust beneficiary, signs the instrument on behalf of the minor;

(2) no conflict of interest exists; and

(3) no guardian, including a guardian ad litem, has been appointed to act on behalf of the minor.

(d) A written instrument is final and binding on an unborn or unascertained beneficiary if a beneficiary who has an interest substantially identical to the interest of the unborn or unascertained beneficiary signs the instrument. For purposes of this subsection, an unborn or unascertained beneficiary has a substantially identical interest only with a trust beneficiary from whom the unborn or unascertained beneficiary descends.

(e) This section does not apply to a written instrument that modifies or terminates a trust in whole or in part unless the instrument is otherwise permitted by law.

Subsection (e) of the new statute seemingly shuts the door on using it for trust modifications and terminations. However, one person's "modification" is another person's "agreement relating to a trustee's duty, power, responsibility, restriction, or liability."

The drafters of Section 114.032 apparently intended it to be useful in obtaining releases of the trustee which are binding on minors and unborn persons, and subparagraph (e) seems to present no impediment to that. For example, if the trustee discovers that it made a mistake, it can make a full disclosure of the mistake, offer some sort of restitution to the trust, and get a release from the current beneficiaries. This statute would make that agreement binding on minors and unborn persons in many cases, since their interests would be "substantially identical" to their parents or other beneficiary.

5. Selected Problem Areas in Trust Modification and Termination

5.1. *Tax Issues Affecting Trust Modifications, Combinations and Decanting*

This paper looks at the state law issues surrounding trust modifications and termination, not the tax issues. There are potential tax implications to trust modifications, combination and decanting. The growth of decanting has caused a new focus on the tax implications of changing trust terms. Since 2011, the IRS has had a no-ruling policy with respect to certain issues relating

to decanting arrangements, including whether decanting results in a taxable gift.⁷³ Rulings are possible if the decanting results only in administrative-type changes where there is no change in beneficial interests or the perpetuities period. While the rise in decanting is what is motivating the IRS to take a closer look at these issues, the issues are the same whether the trust change is achieved through decanting, judicial modification, nonjudicial modification or trust combination.

Melissa Willms's paper "Decanting Trusts: Irrevocable Not Unchangeable," 20th Annual Advanced Estate Planning Strategies Course (2014), includes an excellent discussion of tax issues involved with decanting or modifying trusts. The author thanks Melissa for discussing these issues with him.

5.2. Does a Trustee Have a Duty to Seek Trust Modification or Termination?

Does a trustee have a duty to petition the court to modify or terminate a trust if that action is necessary to prevent waste or avoid impairment of the trust's administration? Restatement (Third) of Trusts §66 (2003) provides:

- (1) The court may modify an administrative or distributive provision of a trust, or direct or permit the trustee to deviate from an administrative or distributive provision, if because of circumstances not anticipated by the settlor the modification or deviation will further the purposes of the trust.
- (2) If a trustee knows or should know of circumstances that justify judicial action under Subsection (1) *with respect to an administrative provision*, and of the *potential of those circumstances to cause substantial harm to the trust or its beneficiaries*, the trustee *has a duty to petition the court for appropriate modification of or deviation from the terms of the trust*.

[Emphasis added]

The comments to this section of the restatement provides that this duty of the trustee "ordinarily does not apply to the initiation of proceedings for modification of or deviation from *distributive provisions of a trust*." But the comment continues: "[I]f the trustee is *actually* aware that a purpose of the settlor would be jeopardized by adhering to existing provisions governing distribution when judicial action under Subsection (1) would be justified, the trustee has a duty to petition the court for instructions or for appropriate deviation or modification."

An example of a situation in which Subsection (2) – imposing the duty in a case where the trustee knows or should know of the potential of circumstances to cause substantial harm to the trust or its beneficiaries – may apply is where the trust terms prohibit the sale of an asset which is likely to decline in value significantly if the trust continues to hold it. In such a case, the trustee

⁷³ See Rev. Proc. 2015-3, §5.01(20), 2015-1 I.R.B. 129.

may have a duty to seek court relief from the terms of the trust requiring the trustee to hold the asset.

If the beneficiary would benefit if a trust was a special needs trust but there is a provision of the trust which prevents it from qualifying as a special needs trust, does the trustee have a duty to seek judicial modification or reformation, decant the trust or take some other action to fix the problem? The restatement comments suggest that the trustee of such a trust may have a duty to seek instructions or modification of the trust terms to make the trust a special needs trust, allowing the trust beneficiary to qualify for benefits.

5.3. *Charitable Beneficiaries*

5.3.1. *Charity/Attorney General Involvement*

As in most states, in Texas the attorney general is authorized to protect the public's interest in charities. There are obvious, valid reasons for this. One of the ways in which the attorney general gets involved in litigation involving charities is found in Chapter 123 of the Texas Property Code. While that chapter is entitled "Attorney General Participation in Proceedings Involving Charitable Trusts," the definitions of "charitable trust," "charitable entity" and "proceeding involving a charitable trust" in Section 123.001 give it broad applicability. This paper discusses charitable trusts in the traditional, trust law sense – an express trust with one or more charitable beneficiaries.

In most actions involving a charitable trust, the proceeding will affect the interest of the charity as beneficiary, and therefore the charity must be made a party. Additionally, the party initiating any proceeding involving a charitable trust is required to give notice to the attorney general by sending the attorney general, by registered or certified mail, a copy of the petition or other instrument initiating the proceeding involving a charitable trust within 30 days of the filing of such petition or other instrument, but no less than 25 days prior to a hearing in such a proceeding.⁷⁴ The attorney general is a proper party and may intervene in a proceeding involving a charitable trust at any time. Additionally, the attorney general may enter into a compromise, settlement agreement, contract or judgment relating to a proceeding involving a charitable trust.⁷⁵

While the folks at the charitable trusts section are no doubt just doing their jobs, they can throw a monkey wrench into what is otherwise a fairly straightforward solution to problems involving a trust. When trying to terminate or modify a trust with a remote contingent charitable beneficiary, the attorney general's involvement may impede the ability of the family to come to a fair solution. Charities themselves do not usually take positions which are adverse to those taken by family members. Often the charities have worked closely with the family and are comfortable

⁷⁴ Tex. Prop. Code §123.003(a).

⁷⁵ Tex. Prop. Code §123.002.

with the proposed solution. However, because of the nature of the task undertaken by the attorney general — protecting the theoretical interests of the general public — the attorney general often is forced to end up on the opposite side of everyone else at the negotiating table. It is critical to give the required notice under Tex. Prop. Code §123.003 in a timely manner and to cooperate as much as possible with the attorney general's representative. It also is a good idea to establish contact with the charity first to have a good relationship established before the attorney general's office looks at the file. If the assistant attorney general sees that the charity is actively involved in the proceeding, he or she may be more likely to pass on the opportunity to become involved in the proceeding.

5.3.2. *Cy Pres*

Generally speaking, the cy pres doctrine is a rule for the construction of instruments in equity by which the intention of the party is carried out as near as may be when it would be impossible or illegal to give it literal effect. More commonly, it is the equitable power which enables the court to carry out a testamentary or inter vivos trust established for a particular charitable purpose if the testator/settlor has expressed general charitable intent but for some reason his purpose cannot be accomplished in the manner specified in the will or trust instrument.

Previously a judicial proceeding with attorney general involvement was the only way to get a new charitable beneficiary if the one in the trust instrument failed and the trust instrument was silent as to its replacement. For trusts created on or after August 30, 1999, Section 113.026 provides a means for the settlor or trustee to nonjudicially select a new charity to replace the failed charity when the trust instrument is silent. The attorney general still gets notice, and the charity selected still has to fall within the cy pres doctrine. However, if the attorney general chooses not to intervene, the replacement of the failed charity may occur nonjudicially.⁷⁶

5.4. *Problems Unique to the Trustee*

When a modification or termination action is contemplated, the trustee usually faces unique problems and issues. The trustee often finds itself reluctant to modify or terminate while the beneficiaries are enthusiastic about the action, or the trustee may see an immediate need to modify the trust, but the beneficiaries are not so excited about the prospect of reviewing all this legal mumbo-jumbo.

Here are suggestions for trustees when modification or termination is considered:

⁷⁶ Section 113.026 represented a compromise between the proponent of the bill, who wanted broader substitution powers (outside the cy pres doctrine if the settlor was alive and wished to designate a charity which did not have a same or similar purpose) and less attorney general involvement, and the attorney general's office, which wanted the cy pres doctrine to apply in all cases. One unfortunate aspect of the compromise is that the new law only applies to trusts created on or after August 30, 1999. One quirk of the statute is that the attorney general can be held responsible for all court costs of the parties involved if the court determines that the attorney general acted unreasonably in seeking judicial review of the appointment of the replacement charitable beneficiary.

- Retain outside counsel in all but the most routine and small cases. Under *Huie v. DeShazo*,⁷⁷ a trustee's consultations with its attorneys are protected by the attorney-client privilege. The trustee can get (hopefully) good, independent advice and protect its communications about the propriety of terminating or modifying the trust and the problems which may be experienced with beneficiaries.
- Make a full and reasonable disclosure of all material facts, including all material nonstandard transactions. Only by doing so can the trustee have any hope of making an agreement with beneficiaries binding and enforceable.⁷⁸
- If possible, merely agree not to oppose the modification or termination rather than actively seeking, supporting or agreeing to the termination or modification. The trustee has a common law duty to defend the trust, and it is preferable to let the beneficiaries push for the termination of the trust rather than having the trustee out on the front lines. Obviously, this ignores the real world to a certain degree — there are going to be many times when the trustee has to take the lead in a modification or termination, and such action often is entirely accurate. Also, in some cases the trustee may have a duty to seek modification or termination of the trust.⁷⁹
- Make sure the necessary parties are joined, and make sure the parties being virtually represented fall comfortably within the virtual representation statute or doctrine. If there's any doubt, recommend to the court that a guardian ad litem be appointed.
- Remember that trustees not only have a duty to act reasonably when they exercise discretion, they also have a duty to decide whether or not to exercise discretion given to them by the trust instrument. Failure to exercise discretion when it is given (for example, failure to exercise discretion to terminate a small trust using the nonjudicial termination power given the trustee in the trust instrument) can be as much of a breach as exercising the discretion wrongfully or improperly. Document the trust records not only if the trustee chooses to exercise discretion, but also when the trustee chooses not to exercise discretion. For example, a notation may be "considered terminating trust under small trust provision, but decided that the purposes of the trust continue to be served at this time, so termination is inappropriate."
- While this should go without saying and does not have particularly to do with trust modification or termination suits, remember to treat all beneficiaries with courtesy and

⁷⁷ 922 S. W. 2d 920 (Tex. 1996).

⁷⁸ See *Montgomery v. Kennedy*, 669 S. W. 2d 309, 313 (Tex. 1984); Tex. Trust Code §§114.003 and 114.032.

⁷⁹ See "Does a Trustee Have a Duty to Seek Trust Modification or Termination?" above.

respect, and remember that the trustee's internal email probably is discoverable if it exists.

- If the trust is terminated, delay the actual distribution of trust property until the judgment is final. Remember that parties who were virtually represented in the proceeding may have an independent right to appeal the judgment.

6. Conclusion

Modifying or terminating trusts is something most attorneys face at some point in their practices. The author hopes this outline will be a ready resource for those occasions, with both legal and practical advice.

7. Appendix A -- Drafting for Maximum Flexibility

These are examples of trust provisions which provide maximum flexibility to the trustee or trust protector and make it easier to judicially modify a trust. Some provisions are accompanied by explanations and comments.

These provisions should be used with caution because in many cases they are inappropriate.

Purpose Provision

Since Tex. Trust Code Sec. 112.054(a)(2) permits modifications which will “further the purposes of the trust,” including an express statement of the purpose or purposes of the trust makes it easier – or harder – to judicially modify a trust. To make it easier to later modify the trust, include a single broad statement of purpose. To make it harder to later modify the trust, state multiple and detailed purposes of the trust.

7.1. *Purpose of Trust.*

The purpose of the trust is to benefit _____ (the “Primary Beneficiary”).

Flexible Distribution Standard

This distribution standard provides a great deal of flexibility and could be used where the primary beneficiary is the trustee and the settlor’s focus is on benefiting the primary beneficiary and not the remainder beneficiaries.

- By stating the purpose of the trust broadly, it makes it easier to comply with Tex. Trust Code Sec. 112.054 to make judicial modifications.
- It states the HEMS standard broadly, without qualifications, definitions or restrictions.
- It permits consideration of other resources but does not require it.

7.2. *Distributions of Income and Principal.*

While the Primary Beneficiary is living, the trustee may pay and distribute to, or apply for the benefit of, the Primary Beneficiary so much of the principal or income, or both principal and

income, of the trust as the trustee, in the trustee's discretion, determines is necessary or appropriate for the health, education, maintenance and support of the Primary Beneficiary. In making this determination, the trustee is permitted, but is not required, to take into account other resources available to the Primary Beneficiary that are known to the trustee.

Power of Appointment

Including a broad special power of appointment (to any person or entity) gives the remainder beneficiaries a disincentive to question the actions of the beneficiary serving as trustee.

7.3. *Special Power of Appointment.*

The Primary Beneficiary shall have a special power of appointment over the trust estate of the trust as described below:

...

A. *Beneficiaries of Appointed Property.*

The Primary Beneficiary may appoint property to any one or more persons or charity; provided, however, that the Primary Beneficiary may not appoint property to the Primary Beneficiary, to the Primary Beneficiary's creditors, to the Primary Beneficiary's estate or to the creditors of the Primary Beneficiary's estate.

...

State Settlor's Intention to Avoid Application of Rule Against Perpetuities

Include a provision making it clear that the settlor wants the trust to last as long as possible, notwithstanding the Texas rule against perpetuities. This may not be effective under the current Texas law regarding perpetuities, but if Texas ever repeals the RAP or the situs is changed to a state with no RAP, a statement of the settlor's intent may help avoid the RAP.

7.4. *Final Termination of Lifetime Trusts.*

It is Settlor's intention that, unless sooner terminated by the exercise of a power of appointment as provided above, the process of creating new lifetime trusts for each generation of Settlor's

descendants will continue in perpetuity or as long as permitted by applicable law. At the time Settlor signed this instrument, Texas law included a rule against perpetuities, prohibiting non-charitable trusts from lasting longer than 21 years after some life in being at the time of the creation of the interest plus a period of gestation. If it is possible for trusts created under this instrument to last longer than that period of time, then Settlor intends that the trusts created by this instrument shall not be required to terminate due to the rule against perpetuities. Without limiting the foregoing, to the extent possible: (1) if Texas law changes to permit perpetual non-charitable trusts or non-charitable trusts which may continue in existence longer than is permitted under Texas law in effect at the time Settlor made this instrument, then Settlor intends that the trusts under this instrument benefit from the law change; (2) if a trust becomes subject to the law of another state or jurisdiction which permits perpetual non-charitable trusts or non-charitable trusts which may continue in existence longer than is permitted under Texas law in effect at the time Settlor made this instrument, then Settlor intends that the trusts under this instrument should not be subject to the Texas rule against perpetuities; (3) if the property in a trust created under this instrument is distributed to another trust as permitted by the section of this instrument entitled "Distribution to Other Trusts" or under a law permitting decanting of trusts, and if the law applicable to the other trust permits trusts to continue beyond the period that would have been permitted by the Texas rule against perpetuities, then Settlor intends that the other trust should not be subject to the Texas rule against perpetuities; (4) if the property in a trust created under this instrument is combined another trust as permitted by the section of this instrument entitled "Combination of Trusts" or under a law permitting merger or combination of trusts, and if the law applicable to the other trust permits trusts to continue beyond the period that would have been permitted by the Texas rule against perpetuities, then Settlor intends that the other trust should not be subject to the Texas rule against perpetuities; and (5) if the trustee or any interested party petitions a court of competent jurisdiction to permit a trust to continue beyond the period permitted by the Texas rule against perpetuities, Settlor intends that this action should be given effect. If, despite this intention, under applicable law a trust must terminate at some date in order to be effective, then the trust shall terminate on the last possible day, and if the termination date is based on measuring lives, the lives used for measuring that termination date shall be those natural persons named in this instrument and their descendants who are alive at the time Settlor signed this instrument. If a trust terminates under this provision, the trustee shall distribute the then-remaining trust estate (if any) to the Primary Beneficiary, if he or she is then living, and if the Primary Beneficiary is not then living, to the descendants of the Primary Beneficiary, per stirpes, and if none of the Primary Beneficiary's descendants are then living, then to the descendants of the parent of the Primary Beneficiary who is related to Settlor by blood or adoption, per stirpes, and if none of the descendants of that parent of the Primary Beneficiary are then living then to Settlor's descendants, per stirpes, and if none of Settlor's descendants is then living, then the trustee shall distribute the remaining trust estate to the Alternate Takers (as defined later in this instrument).

7.3. *Independence of Trustee.*

Unless in conflict with applicable local law, each trust shall be administered free from the active supervision of any court. Nothing in this instrument prevents the trustee from seeking a judicial

determination by a court with respect to one or more specific issues or to seek a judicial modification of the trust as permitted by law.

7.4. *No Disqualification Due to Conflict of Interest.*

No person is disqualified from serving as a fiduciary because he or she has an interest in a Settlor's estate or any trust or because he or she has a claim against any estate or trust.

7.5. *Waiver of Bond.*

No fiduciary shall be required to give bond in any jurisdiction, unless bond is required by law or court rule which cannot be waived, and in that event no surety shall be required.

7.6. *Compensation.*

Each trustee shall be entitled to reasonable compensation and for reimbursement of expenses. Nothing contained in this section shall be construed to require any person to accept compensation for serving as a trustee.

Limit Disclosure Obligations

If the primary (income) beneficiary is the trustee of the trust, limit the trustee's duty to disclose information about the trust as much as possible. Do not include a provision requiring the trustee to account. Omitting a duty to provide periodic accountings makes the Texas default rule apply, which means that a beneficiary must demand an accounting in order to be entitled to receive one. Since most individual trustees do not provide periodic accountings to all beneficiaries, this removes a trap for the trustee. (Note that the trustee probably has a duty to disclose material information to beneficiaries even if the document contains no express duty to account.)

7.7. *No Disclosure to Certain Beneficiaries.*

To the extent permitted by law, Settlor relieves each trustee from the duty to keep remote beneficiaries and beneficiaries under the age of 25 years informed concerning the administration of the trust and the material facts necessary for the beneficiaries to protect the beneficiaries' interests, and Settlor relieves each trustee from the duty to inform beneficiaries under the age of 25 years of the existence of the trust. Also, to the extent permitted by law, remote beneficiaries shall not be entitled to demand an accounting from the trustee under Section 113.151 of the Texas Trust Code, and the trustee is not required to respond to demands for accountings from remote beneficiaries. For purposes of this section, "remote beneficiaries" are beneficiaries who are neither entitled nor permitted to receive current distributions from the trust and who would receive no distribution from the trust if the trust then terminated.

Broad Trust Protector Powers

This gives the trust protector very broad powers and is appropriate only in cases where those broad powers are desired. Including this provision could permit the effective rewriting of the trust instrument. Conversely, including this provision could adversely affect the Primary Beneficiary if the trust protector acts contrary to the Primary Beneficiary's wishes.

7.8. *Trust Protectors.*

7.8.1. *Appointment of Trust Protectors.*

Subject to the power given below to trust protectors to designate successor trust protectors, _____ shall serve as trust protector of the trust, and if _____ dies, becomes incapacitated, resigns or otherwise fails or ceases to serve as trust protector of a trust, then _____ shall serve as substitute or successor trust protector of the trust. If there is no trust protector serving with respect to a trust and if there is no other provision for the appointment of a successor trust protector, the trustee of the trust may appoint one or more trust protectors of that trust. If, upon the termination of the trust with respect to which the trust protector is serving, one or more other trusts are created or established under the terms of this instrument, the trust protector of the terminating trust shall serve as trust protector of each trust then created or established, unless a different trust protector is named or designated to serve with respect to that trust.

7.8.2. *Powers of Trust Protectors.*

Subject to the limitation of the powers of a trust protector regarding taxes stated below, the trust protector shall have the following powers and duties:

A. *Designate Successor Trust Protectors.*

The trust protector may designate one or more persons to serve as successor trust protector in the event that a vacancy later occurs in the office of trust protector for any reason, and the successor trust protector so designated shall take priority over the successor trust protectors which may have been named in the instrument and over those previously designated by the current or former trust protector or trustee. The trust protector may name multiple successors, specify the order of preference and priority of service and specify the requirements which future trust protectors must meet.

B. *Appoint Co-Trust Protectors.*

The trust protector may appoint one or more co-trust protectors to serve with the trust protector. A co-trust protector who is so appointed may or may not be an independent trust protector.

C. *Appoint Special Trust Protector.*

The trust protector may from time to time appoint a person or entity to serve as special trust protector with respect to a trust. The special trust protector may or may not be an independent trust protector. The appointment of any special trust protector shall be evidenced by an instrument in writing signed by the trust protector and delivered to the trustee of the trust and to the special trust protector, which instrument may specify the rights and powers of the special trust protector, the limitations on the special trust protector's right and power to act, the compensation to be paid to the special trust protector (if any), the term of the special trust protector and the manner in which the special trust protector may be removed. Unless such written instrument provides otherwise, the special trust protector may be removed by the trust protector at any time.

D. *Remove Trustee.*

The trust protector may remove a trustee of any trust, whether individual or corporate.

E. *Fill Trustee Vacancies.*

The trust protector may fill any vacancy which may occur in the office of trustee of any trust, including but not limited to a vacancy occurring because of the removal of a trustee. Without limitation, the trust protector may appoint himself or herself as trustee.

F. *Designate Successor Trustees.*

The trust protector may designate one or more persons or entities meeting the requirements of this instrument to serve as trustee or successor trustee of any trust in the event of a vacancy in the office of trustee or in the event that a vacancy later occurs in the office of trustee for any reason, and the successor trustee or trustees so designated shall take priority over the successor trustee or trustees which may have been named elsewhere in this instrument and over those previously designated by the current or former trust protector. The trust protector may name multiple successors, specify the order of preference and priority of service and specify the requirements which future trustees must meet, so long as the requirements are not less restrictive than the requirements set in this instrument. The power of the trust protector to appoint trustees or successor trustees also shall apply to any trust which may be established or created upon the termination of the trust with respect to which the trust protector is serving unless a different trust protector is named to serve for that trust.

G. *Appoint Special Trustee.*

The trust protector may from time to time appoint a person or entity meeting the successor trustee requirements of this instrument to serve as special trustee (1) to administer that property which the trust protector, in the trust protector's discretion, determines cannot or should not be administered by the trustee of the trust,or (2) to hold and exercise the power and authority to take or refrain from taking one or more actions which the trust protector, in the trust protector's discretion, determines cannot or should not be held or exercised by the trustee of the trust. The special trustee may or may not be an independent trustee. The appointment of any special trustee shall be evidenced by an instrument in writing signed by the trust protector and delivered to the trustee of the trust and to the special trustee, which instrument may specify the rights, powers, duties and liability of the special trustee, the property which is subject to the special trustee's control, the limitations on the special trustee's right and power to act, the compensation to be paid to the special trustee (if any), the term of the special trustee and the manner in which the special trustee may be removed. Unless such written instrument provides otherwise, the special trustee may be removed by the trust protector at any time. Unless such written instrument provides otherwise, upon removal of the special trustee or the expiration of the special trustee's term, the property being administered by the special trustee and the power and authority granted to the special trustee shall be returned to the trustee. Unless such written instrument provides otherwise, the special trustee may act without bond or other security.

H. *Authorize Distributions to Other Trusts.*

The trust protector may direct the trustee to transfer the property of a trust to the trustee of another trust as provided in the section of this instrument entitled "Distribution to Other Trusts."

I. *Direct the Trustee to Combine Trusts.*

The trust protector of a trust who is an independent trust protector may direct the trustee to take one or more of the actions described in the section of this instrument entitled "Combination of Trusts."

J. *Terminate Trust Early.*

The trust protector of a trust who is an independent trust protector may terminate the trust prior to the date upon which it would otherwise terminate under the terms of this instrument for any reason and without court approval. If the trust protector so terminates the trust, the trustee shall distribute the property of the trust to the Primary Beneficiary of the trust, if living, or to the persons who would be entitled to receive the property on the Primary Beneficiary's death, if the Primary Beneficiary is not living.

Amending Trust Instrument

An independent trust protector may be given the power to make substantive changes to the dispositive provisions of the trust – add beneficiaries, remove beneficiaries, change the distribution standard, etc. This provision permits reformation or amendment to achieve tax objectives or to qualify for government benefits, but it does not have to be limited in this way.

K. *Reform or Amend Instrument.*

The trust protector of a trust who is an independent trust protector may reform or amend the terms and provisions of this instrument governing the trust, but only if and to the extent the trust protector determines the reformation or amendment is necessary (1) to achieve the tax objectives the Settlor intended or which the trust protector believes Settlor would have intended had Settlor known of the tax issues involved or (2) to qualify a beneficiary to receive benefits under one or more government programs.

L. *Change Trust Situs.*

The trust protector may change the situs of any trust as provided in the section of this instrument entitled “Applicable Law; Situs of Administration.”

7.8.3. *Limitation of Powers of Trust Protector Regarding Taxes.*

Notwithstanding the other provisions of this instrument, a trust protector may not hold or exercise any power or take any action as trust protector which would:

1. Cause any portion of the principal or income of the trust to be includable in the trust protector’s estate for federal estate tax purposes;
2. Cause the trust protector to hold a general power of appointment over any portion of the principal or income of the trust for federal gift or estate tax purposes that is not limited by an ascertainable standard; or
3. Discharge a legal obligation of the trust protector.

7.8.4. *Administrative Matters Related to Trust Protectors.*

A. *Trust May Have No Trust Protector.*

No trust is required to have a trust protector. All trusts are not required to have the same trust protector.

B. *Rights and Duties Apply to Successor Trust Protectors.*

All rights and powers given to, and all duties imposed on, the trust protector also apply to and are binding upon each substitute or successor trust protector. The trust protector, whether original, substitute or successor, whether individual or corporate, and whether one or more, is referred to in this instrument as “the trust protector.”

C. *No Compensation.*

The trust protector shall serve without compensation but shall be entitled to have his or her reasonable and necessary expenses paid from the trust; provided, however, that a special trust protector may be paid compensation if the terms of the written instrument appointing the special trust protector so provide. Any trust protector may employ and rely upon the advice of accountants, attorneys, investment bankers and other agents, the cost and expense of which shall be paid from the principal of the trust.

D. *Waiver of Bond.*

A trust protector is not required to give bond or other security.

E. *Multiple Trust Protectors.*

If there are two trust protectors of a trust, actions of the trust protector must be approved by the trust protectors unanimously, and if there are three or more trust protectors of a trust, actions of the trust protector must be approved by a majority of the trust protectors; provided, however, that if this instrument requires a decision to be made or action to be taken by a trust protector who is an independent trust protector, then the decision shall be made or the action shall be taken by the independent trust protector or protectors to the exclusion of any one or more trust protectors who are not independent trust protectors.

7.8.5. *Duties of Trustee to Trust Protector.*

The trustee shall pay the compensation of a special trust protector (if any) and the costs and expenses of the trust protector and the trust protector’s accountants, attorneys, investment bankers and other agents from the trust and allocate the payments to trust income. The trustee shall provide the trust protector with information about the trust, including a copy of the trust instrument, a trust accounting and material information related to the administration of the trust if and to the extent requested to do so by the trust protector. Unless otherwise provided in this instrument, the trustee has no duty to provide information to the trust protector or to keep the trust protector informed about the administration of the trust if and to the extent requested by the trust protector.

7.8.6. *No Requirement to Act; Liability of Trust Protector.*

1. The trust protector is not required to investigate, monitor, supervise or approve the actions of the trustee and is not liable or responsible for any acts or omissions by the trustee, any breaches of fiduciary duty by the trustee or any other loss or damage caused by the trustee. Without limiting the foregoing, the trust protector has no duties, responsibilities or liability related to trust investments and trust distributions.

2. The trust protector is not a trustee or a co-trustee and is not liable as such. Without limiting the foregoing, the trust protector is not held to the standard of conduct imposed on co-trustees by Section 114.006 of the Texas Trust Code and has no duty or obligation of any kind to prevent a trustee from committing a serious breach of trust or to compel a trustee to redress a serious breach of trust.

3. The trust protector is not required to investigate the actions of prior fiduciaries and is not liable for the acts and omissions of current or prior fiduciaries.

4. The trust protector is not required to take any of the actions permitted by the trust protector or to exercise any of the powers granted to the trust protector in this instrument. The trust protector has no liability for refusing or failing to act or exercise a power under this instrument.

5. If a person or entity is serving as trust protector of more than one trust created by this instrument, the person or entity may take different actions with respect to different trusts and may act with respect to one trust and fail or refuse to act with respect to another trust without liability.

6. The trust protector cannot be compelled to act or exercise a power by a beneficiary or a trustee. Without limiting the foregoing, a trust protector who acts or exercises a power in one instance cannot later be compelled to act or exercise a power in a different instance.

7. If the trust protector takes an action permitted by this instrument or exercises a power granted by this instrument, then, with respect to that action or exercise:

a. The trust protector shall have the sole and absolute discretion to act with respect to the action; and

b. The trust protector is acting as a fiduciary, owes duties to the beneficiaries of the trust, and is required to act in good faith, but an individual serving as trust protector shall not be personally liable for failing to meet the standards of conduct imposed on fiduciaries by the Texas Trust Code, by applicable common law or by this instrument, so long as he or she did not act in bad faith or was not guilty of gross negligence.

Decanting

Rather than relying on the statutory decanting power, include a broader express power to decant (or specifically deny the power to decant – one or the other).

7.8.7. *Distribution to Other Trusts.*

The trust protector of any trust who is an independent trust protector shall have the power to direct the trustee to transfer all or part of the property in the trust to the trustee of one or more other trusts benefitting one or more of the beneficiaries of the trust, regardless of the distribution standard applicable to the trust, regardless of the terms of the trust receiving the distribution and regardless of the situs of the trust receiving the distribution; provided, however, that the trust protector may not direct the trustee to transfer the property to a trust of which the trust protector is a beneficiary or to a trust of which any person that the trust protector has a legal obligation to support is a beneficiary. If the trust protector so directs the trustee to act, the trustee shall act in accordance with that direction and shall have no liability to the trust, to any beneficiary or to any other person for acting in accordance with that direction. To the fullest extent permitted by applicable law, in exercising the power described in the section, the trust protector shall be entitled to act as provided in this instrument free of any court approval or supervision and free of any statutory restrictions or requirements which otherwise may apply (including, but not limited to, the restrictions and requirements stated in Sections 112.071 – 112.087 of the Texas Trust Code).

Combination of Trusts

A broad combination of trusts provision provides an alternative to decanting in appropriate situations.

7.9. *Combination of Trusts.*

If at any time the trust protector who is an independent trust protector becomes aware of another trust for the benefit of the Primary Beneficiary, whether or not the terms of the other trust are substantially similar to the terms of this trust, the trust protector, in the trust protector's discretion, may direct the trustee to transfer and combine all of the assets then held in the trust established under this instrument to and with the other trust and thereby to terminate the trust under this instrument, or to accept the assets of the other trust which may be transferred to it pursuant to a combination of trusts and to administer and distribute the assets and property so transferred in accordance with the provisions of this instrument.

Waiving the Duty to Diversify

To provide the trustee with maximum flexibility regarding investments, include a provision waiving the duty to diversify. Some cases do not permit a broad waiver of the duty to diversify if the waiver does not describe specific assets or types of assets or specific reasons for the waiver.

7.10. No Duty to Diversify Investments.

Settlor anticipates that part or all of the trust property may be invested in real property, in one or more limited partnerships or other closely held business entities or in a concentration of one or more securities. Settlor gives to the trustee the maximum flexibility regarding investments even if those investments are not diversified. The trustee is permitted to invest any portion of the trust property -- up to the whole thereof -- in one or more parcels of real property or in one or more entities or securities without regard to the lack of liquidity this may cause and without regard to the fact that the investments of the trust may not be diversified as may otherwise be required by the Texas Trust Code or other applicable law. Settlors do not intend for the trustee to be compelled to sell assets of the trust to achieve diversification. The trustee is relieved of the duty to diversify investments.

7.11. Transactions With Trustees, Trust Protectors and Beneficiaries.

The trustee may enter into transactions (including but not limited to purchases, sales, leases, and loans with or without collateral) on behalf of the trust with the trustee, individually, with another trustee, with a trust protector, with the personal representative of Settlor's estate or the estate of a trustee, trust protector or beneficiary, with any one or more beneficiaries of the trust or with a relative of a trustee, trust protector or beneficiary, so long as the transactions are on terms that are fair and reasonable to the trust, and the duty of loyalty otherwise imposed by law is waived for this purpose; provided, however, that Settlor does not intend to give the trustee, the trust protector or any beneficiary a general power of appointment for federal gift and estate tax purposes or to expose the assets of the trust to the claims of creditors of any beneficiary, and this instrument shall be construed and, if necessary, reformed to be consistent with that intent. Without limiting the foregoing, Settlor anticipates that the trustee may wish to purchase or sell assets to or from, or loan money to or borrow from, Settlor's estate or another trust established by Settlor or by a relative of Settlor, and the trustee is expressly authorized to do so.

7.12. Standard of Liability.

Each trustee may depart from the self-dealing rules otherwise applicable to trustees without liability for profits received, so long as he or she believed the self-dealing transaction to be fair when he or she entered into it and so long as the self-dealing transaction was not entered into in

bad faith or with gross negligence. No trustee shall be personally liable for a breach of trust, so long as he or she did not act in bad faith or was not guilty of gross negligence.

7.13. *Spendthrift Trust.*

Each trust created under this instrument is a “spendthrift trust” as that term is used in Section 112.035(b) of the Texas Trust Code. No beneficiary shall have any right to anticipate, alienate, transfer, or encumber any part of the beneficiary’s interest in any trust created by this instrument. The interest of each beneficiary in each trust created by this instrument shall be free from control or interference by any creditor or the spouse of any beneficiary and shall not be liable for the beneficiary’s debts or obligations (including alimony and child support), whether contractual or by tort, and shall not be taken by any person by any process whatsoever and shall not be subject to attachment, garnishment, execution, creditor’s bill, or other legal or equitable process. No spouse or former spouse of a beneficiary is intended to be a beneficiary of any trust, and no spouse or former spouse may compel any distributions from a trust, even if the trustee has failed to distribute property to a beneficiary in accordance with the terms of this instrument and even if the trustee has abused the trustee’s discretion. This section shall apply to all beneficiaries, including any Primary Beneficiary and contingent beneficiaries.

7.14. *Distributions Are Separate Property.*

Property in a trust shall not be considered property of any beneficiary unless and until it is distributed to that beneficiary, at which point it shall be the sole and separate property of the beneficiary. To the extent a court determines that a beneficiary has an interest in any trust, Settlors intend that interest to be the sole and separate property of the beneficiary as to both principal and income, including but not limited to undistributed income. Settlor does not intend for the spouse of any beneficiary to be a beneficiary of any trust or to have any right or interest in any trust. It is Settlor’s intention that both income and principal distributions from each trust are gifts from Settlor to the beneficiary and shall be the beneficiary’s sole and separate property.

7.15. *Waiver of Duty of Impartiality.*

Settlor realizes that, in the course of administering a trust established under this instrument, certain conflicts of interest may develop between the various classes of beneficiaries or between the trustee or trust protector acting in a fiduciary capacity and one or more beneficiaries. Settlor intends for a beneficiary of a trust to be able to serve as trustee or trust protector of that trust, and Settlor expressly authorizes each beneficiary to do so despite any possible conflict of interest. In resolving conflicts, each trustee and trust protector shall be guided by the following priorities, and the duty of impartiality is waived accordingly:

1. The Primary Beneficiary shall be favored at the expense of all other beneficiaries.
2. Life tenants shall be favored at the expense of remaindermen of whatever class.

7.16. *Definitions.*

Avoid *Cy Pres* Proceedings and Charity/Attorney General Involvement

Avoid *cy pres* proceedings by giving the trustee the power to select a substitute charity without notice to or approval of the attorney general.

If the goal is making it easier to modify a trust in the future, then avoid naming a charity as a remainder beneficiary. Instead, make a charity a permissible appointee under a power of appointment and/or include the settlor's charitable giving in a separate document or trust. This keeps the charity (and, therefore, the attorney general) from interfering in a judicial proceeding involving the trust.

7.16.1. *Charity.*

A "charity" is an organization to which a bequest, legacy, devise or transfer from an estate would be deductible under Section 2055 of the Internal Revenue Code. If a gift is made to a charity which has changed its name or which has a successor organization, then the gift shall be made to the charity under its new name or to the successor organization. If a gift is made to an organization identified as a "charity" but does not meet this definition, then the gift to that organization shall not be made and the trustee shall select another charity to receive the gift without the need for any judicial proceeding and without notice to, intervention by or approval of the Attorney General of Texas.

7.16.2. *Independent Trustee.*

An "independent trustee" is a person or entity serving as trustee who is not Settlor, who has no direct or indirect beneficial interest in the trust and who is not related or subordinate to a Settlor or to a person having a direct or indirect beneficial interest in the trust.

7.16.3. *Independent Trust Protector.*

An "independent trust protector" is a person or entity serving as trust protector who is not Settlor, who has no direct or indirect beneficial interest in the trust and who is not related or subordinate to a Settlor or to a person having a direct or indirect beneficial interest in the trust.

7.16.4. *Individual and Corporate Trustee.*

"Individual trustee" means a natural person serving as trustee. "Corporate trustee" means a bank, trust company, financial institution or other corporation or entity serving as trustee. When a corporate trustee merges, is acquired, changes its name or otherwise is reorganized, its successor or assignee shall serve in its place.

7.17. *Applicable Law; Situs of Administration.*

This instrument has been drafted and executed in Texas and Settlor is domiciled in Texas. All questions concerning the meaning and intention of any of its terms and its validity, the rights and duties of fiduciaries and beneficiaries, the administration of any trusts created in this instrument, and the exercise of any power of appointment shall be determined in accordance with the laws of Texas; provided, however, that the trust protector of a trust who is an independent trust protector may, in the trust protector's discretion, from time to time change the situs of that trust from Texas (or its current situs, if different from Texas) to another jurisdiction (whether located in the United States or abroad), in which case the trust shall thereafter be construed in accordance with and governed by the laws of that jurisdiction.